National Audit Office

REPORT

Tax measures to encourage economic growth

HM Treasury and HM Revenue & Customs

SESSION 2023-24
31 JANUARY 2024
HC 445

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Tax measures to encourage economic growth

HM Treasury and HM Revenue & Customs

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 29 January 2024

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Gareth Davies
Comptroller and Auditor General
National Audit Office

19 January 2024

HC 445 | £10.00

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012735 01/24 NAO

Contents

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Key facts

£204bn
summed cost of non-structural tax reliefs using latest available estimates in 2022-23

341
number of non-structural reliefs in 2023

£16.6bn
cost in 2022-23 of 39 reliefs aimed at incentivising business investment

256	number of estimates for non-structural reliefs that HMRC has costed (of which 104 were costed over multiple years)
25	number of non-structural reliefs evaluated since 2015
£600,000	the budget in 2023-24 for commissioning evaluations of tax reliefs
£4.76 billion	cost of Research and Development (R&D) small and medium-sized enterprise (SME) tax relief in 2021-22
575%	overall cash increase in the annual cost of the R&D SME relief between 2013-14 and 2021-22
£1.04 billion	estimated amount of R&D SME relief lost to error and fraud in 2020-21 (the latest year for which data is available)

Summary

1 The government can use tax measures to encourage economic growth by providing tax relief to incentivise certain sectors or activities. Tax reliefs reduce the tax an individual or business owes, and some reliefs make payments back to taxpayers. Some 'non-structural' tax reliefs reflect specific policy choices by ministers to support particular groups or sectors (for example the housing market), while others are designed to incentivise behaviour. As at December 2023 the UK had 341 non-structural tax reliefs intended to achieve social or economic objectives. The government can introduce, amend or remove a relief without making wholesale changes to the wider tax system.

2 Ministers introduce and amend tax reliefs through 'fiscal events' (predominantly legislative changes made once or twice a year announced at the Spring Budget and Autumn Statement, and voted on by Parliament). HM Treasury and HM Revenue & Customs (HMRC) are responsible for all aspects of the effective working of the UK tax system, including tax reliefs. Both departments are responsible for monitoring the effectiveness of reliefs overall. HM Treasury is responsible for strategic oversight of the tax system, including providing evidence-based advice to ministers covering its overall effectiveness. HMRC is responsible for administering the system, including the monitoring and evaluation of specific tax reliefs.

3 HMRC's latest estimates indicate the cost of all non-structural reliefs was around £204 billion in 2022-23 (the latest year for which it has completed all routine estimates). The largest non-structural reliefs – making up around £129 billion of the 2022-23 cost – are not those targeted explicitly at economic growth. These include tax reliefs for pensions, capital gains tax relief on people's main home, and zero-rated VAT on food. Aggregating the cost of non-structural reliefs gives a sense of their scale, but it does not reflect the amount of tax that would be generated if they were removed as some taxpayers may change their behaviour if the reliefs were removed, and there may be wider economic impacts.

4 The National Audit Office reported on non-structural tax reliefs in 2014 and 2020.[1] In 2020 we found that HM Treasury and HMRC had responded to our recommendations by increasing their oversight of non-structural reliefs and actively considering their value for money, but that these steps were very much still in development. We said both departments needed to make substantial progress and ensure sufficient coverage and rigour in their work, including evaluating and reporting on non-structural reliefs. Since then, and in response to our and the Committee of Public Accounts' (PAC's) recommendations, HMRC has made progress in publishing more information on the reliefs, in particular their costs, and has established a framework for future evaluations of reliefs' effectiveness.

5 Tax reliefs can require careful administration to check that they achieve their objectives and costs do not rise disproportionately. Some reliefs can be costly to administer. Our reports, and our annual work on HMRC's financial statements, have recorded instances of large-scale error and fraud involving some reliefs, most recently the Research and Development (R&D) small and medium-sized enterprise (SME) relief. The scale of error and fraud against this relief is still becoming apparent, but it has likely cost the Exchequer several billion pounds.

Scope of the report

6 This report focuses on reliefs intended to promote economic growth, within the wider system of tax reliefs. We examined whether HM Treasury and HMRC have an effective system in place to manage and respond to risks affecting tax reliefs with economic objectives in a timely and proportionate way. We considered:

- to what extent HMRC has improved its assessment of the costs of non-structural reliefs;
- whether HMRC has proportionate and timely monitoring and evaluation of whether objectives are being achieved;
- whether HMRC assesses and monitors the risk that tax reliefs are misused and acts sufficiently quickly to respond where abuse arises; and
- whether HM Treasury and HMRC learn and apply lessons from experience to minimise the risk of abuse and meet objectives in an administratively efficient way.

1 Comptroller and Auditor General, *Tax reliefs*, Session 2013-14, HC 1256, National Audit Office, April 2014; Comptroller and Auditor General, *The effective management of tax reliefs*, Session 2014-15, HC 785, National Audit Office, November 2014; and Comptroller and Auditor General, *The management of tax expenditures*, Session 2019-20, HC 46, National Audit Office, February 2020.

7 Part One of this report provides an overview of non-structural reliefs, including their cost. Part Two examines the departments' understanding of whether non-structural tax reliefs are meeting their economic objectives. Part Three considers how HMRC manages and responds to risks of abuse of non-structural reliefs. We used a range of criteria to select as case studies seven reliefs with objectives to increase investment by or into businesses. These reliefs are the Research and Development (R&D) Expenditure Credit, R&D relief for SMEs, the Annual Investment Allowance, the First-year allowance for plant or machinery for oil and gas trades, Business Asset Disposal Relief, High-end Television Tax Relief, and Video Games Tax Relief. These were estimated to cost £14.9 billion in 2021-22. Appendix One describes our evidence base and methodology.

Key findings

Oversight of non-structural reliefs with economic objectives and how much they cost

8 HM Treasury and HMRC have made a number of important improvements to how they administer, evaluate and report on tax reliefs. Following our reports in 2014 and 2020 the departments have made significant improvements including: publishing objectives for all non-structural reliefs; greatly increasing the number of cost estimates to 256 (out of 341 reliefs) in 2023; and starting to publish high-level commentary on movements in the cost of significant reliefs. The departments have developed a joint framework for designing new reliefs, revising reliefs and monitoring them. In 2021 HMRC published a framework for evaluating reliefs, with criteria for selection within a dedicated annual budget (paragraphs 1.4, 1.13, 1.14, 2.5 and 2.28).

9 In 2022-23 the total cost of the 104 non-structural tax reliefs for which HMRC has data was £204 billion, equivalent to 25% of all tax revenue. This December 2023 cost estimate covered 104 reliefs where HMRC has been able to estimate costs for the last six years. For reliefs where a multi-year estimate is not possible HMRC has investigated the option to produce single-year estimates. This work has identified an additional £19 billion of cost in the years 2016-17 to 2022-23 (paragraphs 1.5 and 1.6).

10 The government has not identified the number and cost of reliefs with purely economic objectives. HMRC publicly stated the objective for each non-structural relief with economic or social objectives in November 2021. There is no agreed population of reliefs targeted at economic growth, and they are not monitored as a group, or compared, for overall effectiveness. We identified 39 reliefs with an objective aimed at increasing UK business investment, 29 of which were costed at £16.6 billion. However, this does not represent a complete list of reliefs with economic objectives (paragraphs 1.8, 1.9, 1.14 and Figure 2).

11 Some tax reliefs with economic objectives have cost far more than forecast. Between 2017-18 and 2021-22 just under half of non-structural tax reliefs had increased in cost. Although some increase is expected due to external factors such as inflation and economic growth, some have increased far beyond HMRC's and HM Treasury's forecasts. The R&D relief for SMEs cost around £15 billion more than HMRC expected it to cost between 2015-16 and 2020-21. The growth was due to large increases in the number of claims each year. The relief for High-end Television introduced in 2013-14 cost £762 million, £557 million (272%) more than HMRC expected it to cost during its first six years. HMRC considers this to reflect unanticipated growth in the industry. Video Games Tax Relief cost £254 million, £179 million (239%) more than initially expected during 2014-15 to 2016-17 (£75 million). Until recently, HMRC based forecast costs for the above reliefs on the Office for Budget Responsibility's (OBR's) general forecast of UK investment and nominal GDP growth, implicitly assuming that businesses claiming a relief will not increase their activity at a faster rate than the UK average. There is no meaningful public reporting where tax reliefs greatly exceed the expected cost (paragraphs 2.5, 2.8 to 2.12 and Figure 6).

HMRC's monitoring and evaluation of whether economic objectives are achieved

12 HMRC has produced an evaluation plan for tax reliefs with economic and social objectives, but has so far only covered a small proportion of them. Tax reliefs to encourage economic growth do not have a statutory timetable for review or reassessment, meaning the responsibility rests on HM Treasury and HMRC to undertake comprehensive, robust and proportionate evaluations of policy interventions as soon as practicable. In December 2021 HMRC produced an evaluation plan specifically for tax reliefs, but this does not set out a schedule for when the evaluations will be completed. Since publishing the plan HMRC has completed two evaluations covering four reliefs for creative industries and three reliefs for share incentive schemes, meaning that it has evaluated 25 since 2015. The summed annual cost of these 25 reliefs is £22.4 billion (based on 2022-23 costs). It has evaluations underway to evaluate more reliefs. Almost all the reliefs selected for evaluation have an economic objective. Once completed HMRC will have evaluated 36 of the 341 reliefs since 2015 (paragraphs 2.17 to 2.19 and 2.28).

13 The government has reduced some reliefs following evaluation, increasing tax revenue by billions of pounds in some cases. In the case of Entrepreneurs' Relief (now Business Asset Disposal Relief), closer monitoring of costs and the evaluation of the extent to which the relief influenced entrepreneurial behaviour helped HM Treasury and ministers understand the relief was costly, ineffective and not value for money. This led to a decision to reduce the lifetime allowance and saved the Exchequer £1.6 billion in 2021-22 alone. In the case of the R&D scheme for SMEs the evaluation identified that the relief's impact on R&D was marginal and reduced with later rate increases. This helped inform advice and led to a policy decision to reduce the generosity of the relief from April 2023. HM Treasury forecast that this change, alongside an increase in the other R&D relief, will lead to a net reduction in costs of £4.5 billion between 2023-24 and 2027-28 (paragraphs 2.22 to 2.25).

14 In some cases government has not amended reliefs for some years after evaluations found they had had a limited effect. A range of factors may influence the speed of response, including the fact that tax reliefs can have a number of objectives and the timeframes for tax policymaking. Reliefs that do not achieve their objectives are costly and the faster that revisions can be made, the greater the opportunity to reduce costs to the Exchequer and improve outcomes. Evaluations since 2015 have identified five reliefs that had limited effectiveness at increasing economic activity. For Entrepreneurs' Relief, and Employment Allowance, there was a three to four-year gap between the date of fieldwork and decisions to amend the relief. The remaining three reliefs have not been amended. These were the reduced National Insurance Contributions for under-21s (estimated cost £850 million in 2022-23) and under 25s (estimated cost £290 million in 2022-23), and rollover tax relief on the purchase of new assets (no cost estimate available for 2022-23). The government announces changes to reliefs, or the introduction of new ones, at 'fiscal events', normally the Budget and Spring Statement and then typically introduces changes after consultation. Ministers may take into account a wider range of factors when deciding on changes to reliefs, including wider government objectives, the priorities of each fiscal event, and levels of Parliamentary support and public perception (paragraphs 2.20 to 2.27 and Figure 9).

15 **Evaluations can contribute to changes that save billions of pounds for the Exchequer, but the government has reduced its budget for evaluation by more than a quarter in 2023-24.** External evaluations remain the main source of evidence for how well a tax relief is performing. Several years of data and claimants' experience of the relief are necessary for a full impact evaluation but reliefs are not routinely evaluated after a set amount of time. In the past three years HMRC has dedicated an average annual budget of £797,000 for evaluating reliefs, reducing the latest budget to £600,000 in 2023-24. The return from HMRC's evaluation of tax reliefs thus far is significant, with billion pound impacts on several tax reliefs where evaluations informed decision-making. This suggests that more rather than less evaluation would improve the Exchequer position. HMRC could have made more use of academic input and improved engagement and resources available for relevant research. Unlike other government departments HMRC does not publish areas of interests where academic input would be helpful. These issues were exacerbated by the closure during the COVID-19 pandemic (the pandemic) of the HMRC 'datalab', which is the facility that allows researchers to access HMRC data. HMRC is now making a range of resource and process improvements to address these concerns (paragraphs 2.29 and 2.30).

Managing the risk of abuse and responding quickly

16 **Some reliefs are subject to large-scale abuse: HMRC estimates that the most likely level of error and fraud on the R&D SME relief was 24.4% (£1.04 billion) of expenditure in 2020-21, the latest year for which data is available.** In past reports we have seen that reliefs have been targets for avoidance or evasion activity. We qualified our opinion on HMRC's 2019-20 accounts due to concerns about error and fraud in the R&D tax reliefs. In response HMRC increased its compliance work starting with a programme to randomly check a sample of claims from December 2020. The first results were not available until 2022-23 and led HMRC to retrospectively raise its estimate of the most likely level of error and fraud for the R&D SME relief in 2020-21 from 5.5% (£0.3 billion) of expenditure to 24.4% (£1.04 billion) (paragraphs 3.1 and 3.6).

17 **HMRC does not know how far back large-scale error and fraud has occurred on the R&D SME relief, but we do know that costs began to increase sharply from 2013-14.** The cost of the R&D SME relief increased by nearly 575% in cash terms between 2013-14 and 2021-22, when it cost £4.76 billion. The way claims are made for this relief, which offers partial relief from corporation tax for SMEs engaged in qualifying R&D activities, has made it attractive to fraudsters. From 2017 and 2018, HMRC identified more tax at risk from poor-quality R&D claims, and from abuse by companies with a limited UK presence. However, HMRC was still concluding as late as 2020-21 that the increases in cost were due to unexpectedly high take-up by eligible claimants on grounds of increased attractiveness and awareness. HMRC's methodology inherently underestimated the level of risk and therefore the level of compliance work necessary, which became clear with the results of its mandatory random enquiry programme for the year 2020-21. The time needed to train new staff and develop new systems affected the pace of HMRC's response. The pattern of cost increases would indicate that HMRC has underestimated the level of error and fraud for some years, and compliance work on older claims may be worthwhile despite the costs and difficulties (paragraphs 3.5, 3.6 and Figures 11 and 13).

18 **The level of error and fraud in R&D SME relief exposed significant weaknesses in HM Treasury's and HMRC's identification and understanding of the risks affecting reliefs with economic objectives; design of controls; and capacity and agility to respond quickly**. The R&D schemes use a definition of R&D based on the Income Tax Act 2007 and accompanying guidelines issued by the Department for Science, Innovation and Technology (DSIT) but understanding claims can require expert knowledge and wording is open to interpretation. Unaccredited agents aggressively solicited taxpayers to submit claims that challenged the definition. HMRC prioritised processing claims quickly in response to the surge in the volume of claims instead of tightening controls. HMRC was too optimistic in assessing the level of non-compliance and as a consequence slow to respond. Post-payment compliance work proved the only means by which HMRC could make a robust assessment of the scale of error and fraud. While the cost of intervening is relatively expensive for HMRC, it is dwarfed by the losses that occurred. HM Treasury and HMRC enhanced pre-payment checking of claims during 2022 and introduced new measures to reduce future error and fraud on the SME relief during 2023, which involved a range of enhanced pre-payment risk assessment activities. These included requiring businesses to: submit claims digitally, with more information; provide a named senior officer; and provide details of any agents involved. The department has not carried out a formal lessons learned exercise from its experience of the R&D SME relief, but has applied lessons in amending this relief and considered steps to improve controls for other reliefs (paragraphs 3.6, 3.11, 3.12 and Figure 13).

19 **HMRC has made greater use of pre-checks and accredited expertise for some similar reliefs**. In some cases HMRC has designed specific interventions for risky reliefs. For example, it reviews claims for Creative Industry reliefs and takes into account sectoral or technical information from partners such as the British Film Institute. HMRC has not been able to put a similar arrangement in place for R&D due to the volume of claims and the technical nature of the relief. HMRC's large increase in post-payment compliance activity since 2022-23 involved bringing in compliance staff who had received training but lacked practical experience in administering this complex relief. There have been widespread stakeholder concerns about the quality of HMRC casework and lack of support to claimants, which HMRC is promising to address through an improvement plan. In August 2023 HMRC developed a revised control framework model setting out its future approach to managing reliefs where claimants make a separate claim for a tax credit (paragraphs 3.9 to 3.13 and Figure 13).

20 **HMRC does not routinely monitor how much compliance activity it is doing for other high-cost reliefs claimed within tax returns, meaning it may not know whether it has sufficient coverage of individual reliefs.** Most reliefs rely on self-assessment by taxpayers. Some offer large financial incentives, such as the 'super-deduction', which offers a 130% deduction for certain types of plant and machinery between 2021 and 2023 (this means that the profit on which a claimant's tax bill is based is arrived at after deducting the entire cost of the relevant plant and machinery, and an additional 30% of that cost). HMRC recognises capital allowances among its strategic risks to tax revenue but does not routinely monitor the amount of compliance activity it is doing at the level of individual reliefs. This is because it is difficult for HMRC to identify specific reliefs within the data on compliance cases worked. At our request HMRC produced compliance data for a sample of tax reliefs with economic objectives, which showed a significant reduction in the number of compliance cases opened for the Annual Investment Allowance case study in 2022-23 compared to 2018-19, although yield from investigations had been increasing year-on-year until 2020-21. HMRC does not consider the risk of non-compliance to be reducing. This partly reflects the reprioritisation of HMRC resources during the pandemic. HMRC has not yet restored compliance work in this area to pre-pandemic levels but opened more cases in 2022-23 than in the previous two years (paragraphs 2.16, 3.8, 3.14 to 3.18 and Figures 6 and 14).

Conclusion

21 Tax reliefs remain an important policy tool for the government to achieve its economic and social objectives. However, the number and cost of these reliefs makes administration a significant task, and there are too many examples where these reliefs either do not achieve their economic objectives or are subject to significant error and fraud, costing the Exchequer billions of pounds. HM Treasury and HMRC have increased the monitoring, evaluation and reporting of non-structural reliefs, but there is still some way to go. Large reliefs, particularly those aimed at economic or behavioural change require close attention. We have seen examples of tax reliefs where the costs have increased quickly, and far beyond expectations, but it has taken a number of years to identify this, understand why, and then to make changes where there are concerns. Cost increases are not necessarily a sign of failure, as they could be the result of genuine increased uptake and delivery of benefits. However, the government cannot know the cause if it has not carried out adequate compliance work to ensure only legitimate claimants received the relief, and evaluation activity to establish that the relief secures the desired outcome. It is important that the government investigates and responds to increases in costs of reliefs and evaluations promptly.

22 It is encouraging that there are now more examples of changes where evaluations have found that tax reliefs are not achieving their economic objectives. HMRC has made important commitments to improve how it evaluates non-structural tax reliefs but it still needs to achieve greater and more timely coverage. HM Treasury and HMRC must ensure that hard lessons are learned from the R&D SME relief, and that they take the steps needed to prevent such a large failure arising again.

Recommendations

23 HM Treasury and HMRC need to build on the improvements they have made so far in administering tax reliefs and make a step-change in how they assess whether tax reliefs achieve their economic objectives, are not too costly, and are not exploited to avoid or evade tax. We recommend:

a HM Treasury and HMRC identify which non-structural reliefs have economic objectives and how these could be grouped together to provide oversight on how reliefs with similar objectives are working together to deliver government objectives, for example those aimed at business investment. This should include assessing the extent to which reliefs are achieving their objectives and whether the economic gains justify the scale of relief.

b HM Treasury should support ministers by ensuring that objectives for reliefs are expressed in as specific and measurable a way as possible. For example, including an expectation of acceptable costs and timescales, and a measurable definition of what success looks like in the advice provided.

c HM Treasury and HMRC should make a clear articulation of resources required to effectively administer and evaluate tax reliefs in tax information and impact notes. HMRC needs to ensure that teams can access the subject matter expertise needed for complex or technical tax reliefs.

d HM Treasury and HMRC should ensure the annual budget for evaluating tax reliefs is commensurate with the number and complexity of reliefs that need evaluating each year. The departments should ensure evaluations are completed in a timely way and commit to publishing evaluations within three months of completion, subject to ministerial approval.

e HMRC should design proportionate controls and plan interventions at the beginning of a relief's lifecycle based on risk assessment and learnings from other reliefs to:

- establish appropriate up-front checks on generous reliefs;
- set out plans for evaluations to be carried out as soon as practicable and publish the timetable;
- plan for timely review of monitoring information to get interim evidence; and
- ensure speed of response where reliefs are identified as not meeting desired objectives or do not function as planned.

f HMRC should improve the transparency of relief costs by committing to provide comparisons of forecast and outturn costs compiled on the same basis. This should also inform internal reporting and analysis:

- HMRC should report where tax reliefs greatly exceed the initial expected costs; and
- HMRC should investigate differences, using robust evidence to form conclusions.

g HMRC should demonstrate that it has applied lessons learned from the problems with the R&D SME relief to other reliefs that could be vulnerable to similar control failures.

h Where the costs of tax reliefs rise rapidly, and beyond an economically credible scenario, HMRC should, where proportionate, investigate a sample of claims to check whether there is widespread non-compliance. It should put in place a rapid response capability where widespread non-compliance occurs.

i HMRC should monitor agent activity to assess the risks for tax reliefs and intervene early where it sees that expected standards of behaviour are not being met.

j HMRC should publicise the areas where it would welcome academic research on tax reliefs.

Part One

Use of tax reliefs to support economic growth

1.1 Tax systems typically include tax reliefs that help to define the scope and structure of the tax system as well as deliver certain objectives. Reliefs can help maintain the competitiveness of tax systems and governments can use tax reliefs as a mechanism to redistribute wealth and support economic growth and influence behaviour. HM Treasury oversees the tax system, including designing tax reliefs. HM Revenue & Customs (HMRC) administers the tax system, including tax reliefs, and maintains tax policy.

1.2 There are two broad categories of tax reliefs: structural tax reliefs and non-structural tax reliefs. Structural tax reliefs are largely integral parts of the tax system. These reliefs have various purposes including defining the scope of taxes and making taxes more progressive (such as the personal tax allowance). Non-structural reliefs are reliefs where government opts not to collect tax to pursue social or economic objectives. In 2019 HMRC classified these reliefs into those that reduce the tax burden on particular groups or sectors (40%), and those designed to encourage a particular behaviour (40%), or to serve a social purpose (20%). Non-structural reliefs are also known as tax expenditures.

1.3 In this part of the report we cover:

- the scale of tax reliefs used to support economic growth, and in particular UK business investment; and
- the administration and oversight of reliefs.

Scope and cost of reliefs to support economic growth

1.4 Following recommendations from the Committee of Public Accounts (PAC) in July 2020,[2] HMRC has committed to "improving the available information about the groups and sectors benefitting from significant reliefs". As at December 2023 there were 341 non-structural tax reliefs (compared with 362 in 2020). HMRC has produced 256 cost estimates for these (compared with 111 in 2020).[3]

1.5 HMRC produces annual cost estimates for 104 reliefs covering the most recent six years with an aggregate reported cost of £204 billion in 2022-23.[4] **Figure 1** overleaf shows a comparison of the summed costs of reliefs with regular cost estimates. These are typically equivalent to over one quarter of UK annual tax revenue. A large proportion of these costs are accounted for by a small group of reliefs which are not targeted explicitly at economic growth – relief from Income Tax and National Insurance Contributions for registered pension schemes (£51.3 billion in 2022-23); relief from Capital Gains Tax on disposal of someone's main residence (£36.7 billion); zero rating of VAT on food (£23.3 billion) and construction and sale of new dwellings (£17.5 billion). Together these account for £129 billion (over half of the total annual cost).

1.6 As at December 2023 HMRC has also produced and published a single-year cost estimate for 150 non-structural tax reliefs.[5] The value of reliefs with published single-year cost estimates is around £19 billion in cash terms. For comparison, this would be the equivalent to 2.3% of tax revenue in 2022-23. Since these reliefs had only been costed for a single year, and that single-year estimate may be several years old, the actual cost could be substantially higher than the estimate. The largest single-year estimates are: reliefs for employer provisions for death or early retirement (£7.8 billion in 2020-21); relief for kerosene used for heating (£2.4 billion in 2017-18); relief on compensation awards for personal injury (£1.3 billion in 2019-20); and relief for vehicles and other supplies to disabled people (£1 billion in 2016-17). Adding the single-year and multi-year estimates together, non-structural reliefs would be the equivalent to 27% of tax revenue in cash terms. However, this does not take into account inflation. It is also difficult to track the trend over time since the cost of the reliefs which have been costed for a single year is unknown beyond the specific year for which each was analysed.

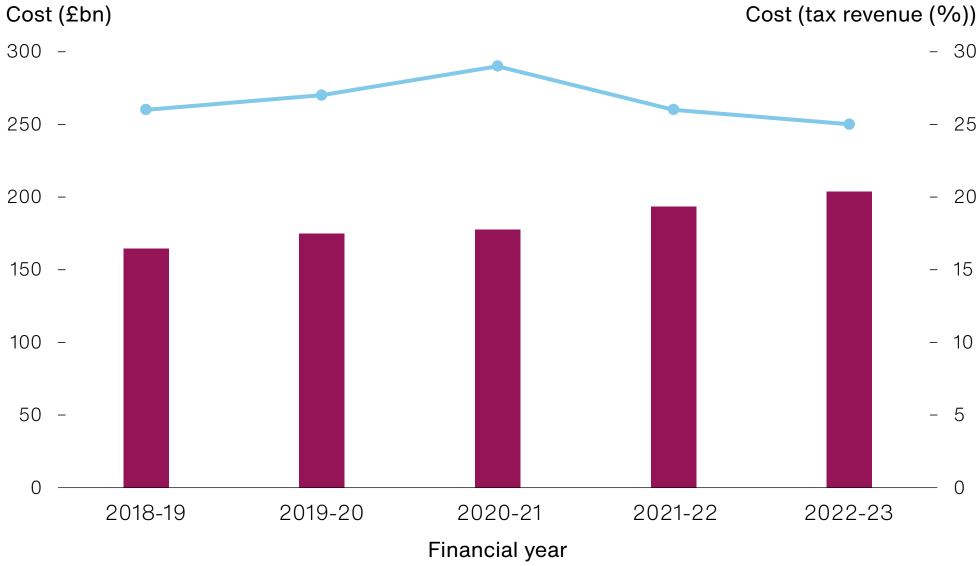
1.7 In 2020-21 tax reliefs increased relative to tax revenue since the pandemic reduced tax receipts that year. As part of the economic response the government also temporarily reduced the rate of VAT for hospitality, holiday accommodation and attractions to support the tourism sector. This cost the Exchequer £3.1 billion in 2020-21 and £5.5 billion in 2021-22.

2 Committee of Public Accounts, *Management of tax reliefs*, Twelfth Report of Session 2019-21, HC 379, July 2020.
3 HMRC has determined that it cannot publish the costs of 27 reliefs due to disclosure rules and a further 22 reliefs cannot be costed due to insufficient data. HMRC has withdrawn the cost of 4 reliefs due to data quality issues. The remaining 32 non-structural reliefs have not been costed.
4 This combined cost does not represent the gain to the Exchequer should non-structural tax reliefs be abolished since these cost estimates do not take into account behavioural changes or wider economic impacts.
5 Further information on the single-year reliefs costed and the 256 total is included in the methodological appendix.

Figure 1

Estimated cost of non-structural tax reliefs with multi-year estimates, 2018-19 to 2022-23

HM Revenue & Customs' (HMRC's) latest annual estimates suggest that non-structural tax reliefs cost at least £204 billion in 2022-23



	2018-19	2019-20	2020-21	2021-22	2022-23
Estimated cost (£bn)	165	175	178	193	204
Estimated cost (tax revenue (%))	26	27	29	26	25

Notes

1 This is based on HMRC's six-year cost estimates produced for reliefs as at December 2023.

2 This includes the 104 reliefs with a six-year costing only and does not include recent reliefs not yet costed. This therefore excludes the super-deduction and freeports since cost estimates are not yet available for these in the December 2023 statistics. HMRC has estimated that the super-deduction, when combined with an extended first-year allowance announced at the same time, would cost the Exchequer an additional £24 billion over the next six years.

3 Data for most reliefs is only available with a two-year lag. Therefore 2022-23 cost estimates are based on internal forecasts and, in some cases, estimates based on third party sources.

4 HMRC also produced cost estimates for 2023-24 in their December 2023 statistical release. We have not included those figures here since these forecasts are subject to high levels of uncertainty.

5 Values are in cash terms to align with HMRC's own reporting of the numbers. To illustrate the trend over time, taking into account inflation and tax-take, it has also been presented as a proportion of tax revenue reported in year.

Source: National Audit Office analysis of HM Revenue & Customs data

Non-structural tax reliefs aimed at promoting economic growth

1.8 Non-structural tax reliefs are intended to achieve economic or social objectives, but this is a very broad grouping, and the level of administration needed will depend on each type. How the effectiveness of a relief is assessed will depend on the extent to which they are intended to have economic or social impacts. There is no agreed population of reliefs targeted at economic growth, and they are not monitored as a group, or compared, for overall effectiveness.

1.9 To provide greater focus we sought to identify the sub-group of reliefs that are targeted at increasing UK business investment, in consultation with HMRC and HM Treasury, as set out in **Figure 2** on pages 19 and 20. Of the 39 reliefs intended to support UK business investment, 29 were costed in 2022-23 representing a total cost of £16.6 billion.[6] We selected seven case studies to examine HMRC's and HM Treasury's administration of tax reliefs with business investment objectives in more detail. More detail on the reliefs chosen and the selection process is provided at Appendix One.

Figure 2

Number and cost of non-structural tax reliefs aimed at promoting UK business investment, 2022-23

HM Revenue & Customs' (HMRC's) December 2023 statistics contain 39 non-structural reliefs designed to incentivise business investment – of these 29 reliefs were costed for 2022-23 representing a total cost of £16.6 billion

Relief category	Largest reliefs	Number of reliefs	Summed cost of reliefs in 2022-23
			(£bn)
Support for business: Research and Development (R&D) and innovation	Research and Development (R&D) tax relief for small and medium-sized enterprises Research and Development (R&D) expenditure credit	3	8.2
Support for business: business investment in assets	Annual Investment Allowance	9	3.0
Support for business: support for a particular sector	First-year allowance for plant or machinery for oil and gas trades Film Tax Relief High-end Television Tax Relief	11	2.9
Support for investors and business owners	Business Asset Disposal Relief Enterprise Investment Scheme Income Tax Relief Venture Capital Trusts Income Tax Relief	16	2.6
Total		**39**	**16.6**

6 Not all of the reliefs have been costed by HMRC.

Figure 2 *continued*

Number and cost of non-structural tax reliefs aimed at promoting UK business investment, 2022-23

Notes

1 Not all of the reliefs had been costed for each year 2018-19 through 2022-23 and six had not been costed at all. This figure covers the sum total of the cost for all of the 39 reliefs in place in this period in 2022-23 and is therefore not a complete cost estimate. For example, the Seed Enterprise Investment Scheme reinvestment relief only had a cost estimate for 2019, and the super-deduction has not yet been costed. The list does not include full expensing since this came into effect after 2022-23.

2 HMRC and HM Treasury do not break down reliefs by whether or not they are intended to support business investment. This listing was generated by the National Audit Office (NAO) using relief descriptions and objectives, with input from HMRC and HM Treasury.

3 The listing includes reliefs that the NAO has identified as directly aimed at incentivising business investment. In practice some reliefs will have different objectives and some are directed at businesses while some are directed at individuals.

4 The values are in cash terms to align with HMRC's own reporting of the numbers.

5 Figures may not sum due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

Administration and oversight of reliefs

Structure of administration and oversight

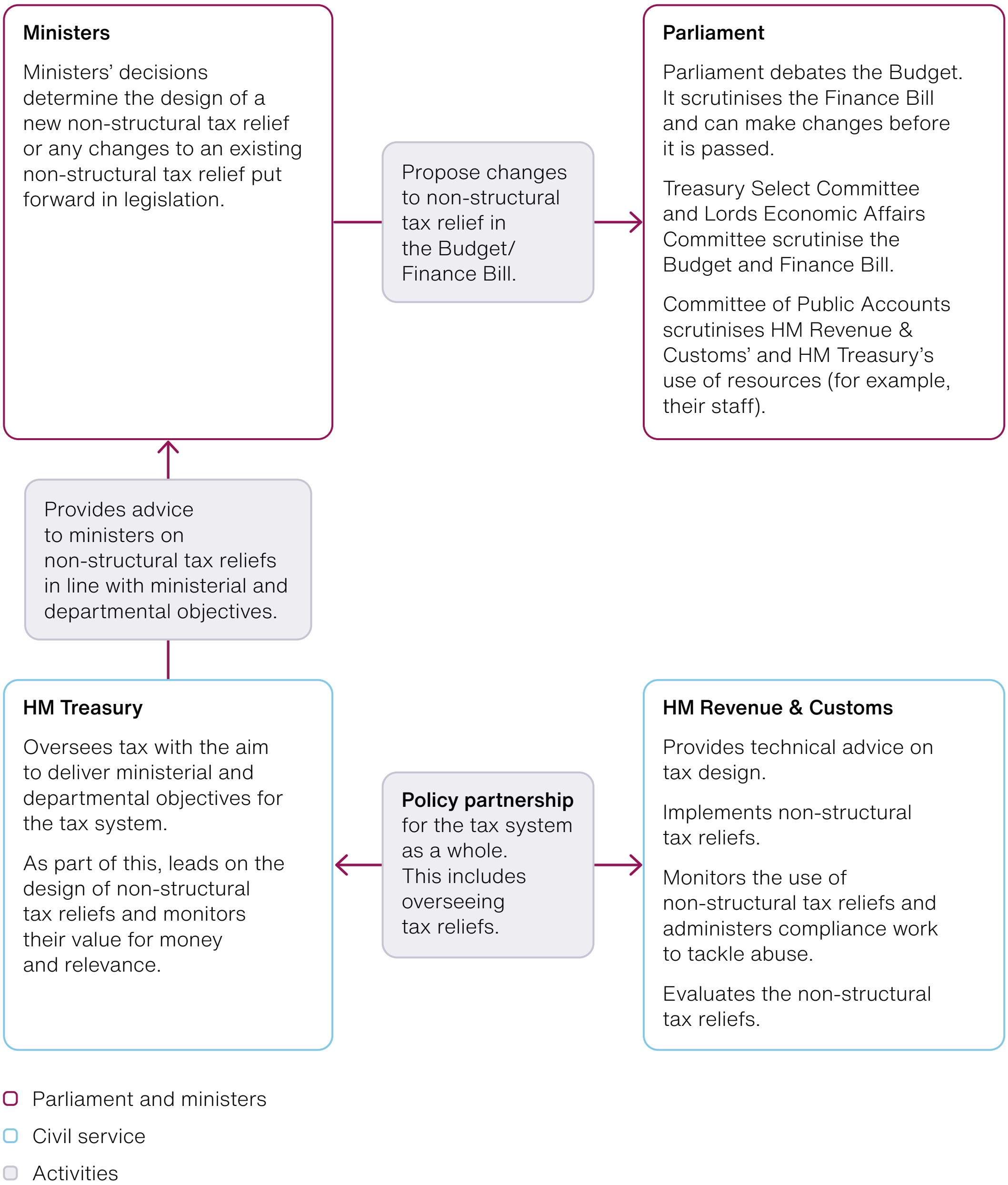
1.10 The government announces changes to reliefs, or the introduction of new ones, at 'fiscal events', normally the Budget and Spring Statement. HMRC and HM Treasury oversee the administration of tax in a policy partnership. HMRC is responsible for administering the reliefs in practice. This includes advising on detailed design of reliefs, putting in place effective controls, undertaking enquiries into claims that it identifies as risks (known as compliance work), and evaluating whether reliefs are meeting their objectives. Feedback from this work feeds into legislation and changes to the system led by HM Treasury. HM Treasury uses this information to advise ministers, who are ultimately accountable to Parliament for the tax system and policy. The roles and responsibilities of the respective departments and that of ministers and Parliament are set out in **Figure 3**.

1.11 In our February 2020 report on non-structural tax reliefs we found that HMRC and HM Treasury had responded to our recommendations by increasing their oversight of non-structural tax reliefs and actively considering their value for money, but that more could be done in the areas of accountability, transparency and evaluation.[7] We set out the importance of clear objectives and baseline costs, continuous monitoring of relief costs and use of evaluation to assess whether reliefs are delivering their objectives. This report focuses on costing and evaluation (in Part Two) and error and fraud detection (in Part Three).

7 Comptroller and Auditor General, *The management of tax expenditures*, Session 2019-20, HC 46, National Audit Office, February 2020.

Figure 3
Tax reliefs: roles and responsibilities

HM Treasury and HM Revenue & Customs work in a policy partnership to advise ministers, who ultimately determine which changes to propose for legislation



Source: National Audit Office

1.12 In the context of tax reliefs this translates into activities to:

- deliver reliefs that are used as stated in their objectives;
- design monitoring and evaluation approaches that are proportionate; and
- put in place processes that enable oversight of developments in costs, benefits, and emerging risks.
- This is illustrated in **Figure 4** on pages 24 to 26.

1.13 Following on from findings by the NAO in 2020 HMRC and HM Treasury have taken steps to improve the monitoring of reliefs by introducing a joint review framework which sets out the work teams are expected to carry out throughout the lifecycle of the relief. This includes setting objectives, risk assessment, monitoring of compliance, and evaluation plans. This is a significant improvement. However, we reviewed the relevant framework documents for our case study reliefs and found that in practice some key sections had not been completed.

1.14 In November 2021 HMRC for the first time published a list of objectives for all reliefs. However, the objectives of many tax reliefs remain unclear. The nature of tax reliefs means that they can have more than one objective. Some incentivise behaviour, while others simply reflect a government policy choice to reduce the tax burden on particular groups or sectors. Since 2011 tax information and impact notes (TIINs) have been used to outline the policy objectives where the government introduces or amends a specific relief in isolation. Since we last reported in 2020 the departments reviewed non-structural tax reliefs and published their objectives in November 2021.

1.15 While the departments have clarified the objectives for each relief, our review of case study reliefs showed that new or amended reliefs did not have specific criteria for measuring success making it difficult to understand the level of change they are intended to make. For example, reliefs with aims to increase business investment do not normally specify the expected magnitude of additional investment by businesses that will result from a given amount of tax relief. A recent exception to this is the TIIN on the full expensing allowance of plant and machinery, published in March 2023. This included an estimate of the impact of the relief.

1.16 TIINs present the full cost to the Exchequer when introducing a new relief but only the net impact to the Exchequer when amending a relief. This means that the budget documents present the incremental effect on tax revenue from amending a relief as opposed to the full expected cost of the relief. Published forecasts sometimes include the wider economic effects but do not separate these from the cost of the relief. While HMRC has retrospectively published the annual cost of 104 non-structural tax reliefs going back six years, there are no baseline forecasts available for stakeholders against which to compare these costs.

1.17 Tax reliefs are not free to administer and are not risk free (**Figure 5** on page 27). Proactive risk work and evaluation are needed to assess whether they provide value for money. Despite these issues, the departments have in the past set aside few resources when implementing a new relief. The TIINs linked to NAO's case studies were in some cases published with limited detail on operational requirements and an expectation that they will be managed as part and parcel of the tax system. HMRC goes through a process to consider potential risks and impacts, the operational response and a measure's delivery complexity. This will include identification and assessment of HMRC operational impacts, including staff resourcing, data and IT requirements. However, for our case study reliefs past policy papers have in some cases considered the cost of operational impacts to be "negligible". HMRC has recently started to publish the operational cost of changes to the reliefs more consistently. The latest changes to the R&D regime assumed additional IT and staff costs of around £56 million would be incurred, while recent changes to AIA and full expensing have also been costed.

Figure 4

Monitoring and evaluation activity possible during the early tax relief policy lifecycle

The level of monitoring and evaluation possible increases in the years after a tax relief is introduced

Tax relief introduced

1 year since introduction

2 years since introduction

Pre-implementation
HM Revenue & Customs (HMRC) plans delivery and system design

Year 1
HMRC receives tax paid over and starts receiving tax returns

Year 2
HMRC receives full set of tax returns from companies

Year 3+
Consecutive years of tax receipts and tax returns

Engagement

Aim
Help taxpayers get it right first time and support design.

Pre-implementation:

- **Consult** stakeholders and experts.
- **Develop clear guidance** and scope upstream needs (such as additional support and customer education).

Year 1 to Year 3+:

- **Continue to engage with stakeholders.** Gather soft intelligence and monitoring to assess uptake and risks. For example, through stakeholder engagement, queries from taxpayers, and helpline information.
- **Refine guidance and support offer** based on feedback and intelligence, review need for updates based on legislation and case-law.

Monitoring and responding to abuse

Aim
Minimise and manage risk of abuse such as error, fraudulent claims, boundary pushing and mis-selling.

Pre-implementation:

- **Early assessment of risks.**
- **Define controls and risk profiles.**
- **Put in place arrangements for data capture** to assess claims value and volume.
- **Forecast uptake and costs.**

Year 1:

- **Re-assess risks** based on emerging intelligence from engagement.
- **Use pre-checking of claims** to assess uptake and risk.

Year 2 to Year 3+:

- **Risk claims and tax returns, and carry out compliance work.** Update risk profiles based on findings from monitoring, compliance work and evaluation findings.

Year 1 to Year 3+:

- **Review controls and claims process** based on monitoring and risking, and – if available – process evaluation.

Year 1:

- Review **emerging evidence from claims and receipts** on uptake against expectation.

Year 2 to Year 3+:

- **Monitor** reported tax liabilities and relief claims.

Evaluation

Aim
Assess whether reliefs are meeting objectives and minimise risk of deadweight.

Pre-implementation:

- **Define objectives.**
- Set out **expected impact** and rationale.
- **Baseline** taxbase and value of reliefs (expected uptake and cost).
- **Plan evaluation** requirement and data collection.

Year 1 to Year 3+:

- **Scope and review triangulatory data** from other sources, such as Companies House and Office for National Statistics.
- **Undertake process evaluation** to understand how the relief is used, by whom, and why.
- **Scope impact evaluation** options.
- **Evaluate impacts** using appropriate data and use available data to consider options to refine and improve the relief. For example, looking at optimal thresholds and rates.

Figure 4 *continued*

Monitoring and evaluation activity possible during the early tax relief policy lifecycle

Notes

1 The Comptroller and Auditor General does not comment on the merits of policy objectives. These characteristics reflect good practice in delivering the policy objectives set. The framework builds on HM Treasury guidance on appraisal and evaluation and the good practice framework previously published in our February 2020 report, 'The management of tax expenditures'.

2 The list of activities is not exhaustive, and since reliefs differ in scope and nature all activities suggested may not be feasible or appropriate. The exact steps taken will depend on the nature, complexity, and cost of the relief. For example, the level of monitoring should be proportionate to the risk, and the choice of evaluation should reflect assessment of proportionality and meaningfulness, in line with HM Treasury guidance on evaluation in government.

3 This graphic illustrates the available data and action possible by year of implementation during the early years of a relief, rather than the actual activity undertaken by HMRC. Many reliefs are in place for a number of years, and monitoring and evaluation should not cease after these initial years but be embedded into business as usual.

4 The period for companies to file their returns is up to 12 months after the year end. Companies can also amend a return beyond this 12-month deadline. In practice, HMRC may have access to tax returns earlier since claims can be submitted before the end of the filing window. For individuals the filing window is shorter than for companies, with self-assessment being due nine months after the year end.

Source: National Audit Office analysis of HM Revenue & Customs (HMRC) data, interviews with HMRC staff and external stakeholders

Figure 5

Key risks in the use of tax reliefs

Reliefs can be effective policy instruments when they are well-designed, but they are not risk free

Risk	Relief does not achieve its objective	Cost of relief is much higher than expected	Relief is subject to error and fraud
Description	Reliefs may wholly or partly fail to deliver the policy outcomes intended. This may mean that the revenue foregone could have been used more effectively elsewhere.	Reliefs may be subject to rapid and unexpected cost increases – unlike spending there is no budget constraint.	Reliefs may be subject to error and fraud, either because of genuine errors made by claimants of the relief, or because the claimant knowingly makes an inflated or wholly ineligible claim.
Cause	The relief: may not have been designed in a way that incentivises claimants in the way desired; is not attractive enough for the intended target group; or encourages unexpected behaviours.	HM Revenue & Customs (HMRC) may have underestimated the attractiveness of the relief or made changes to the relief that rendered the forecast obsolete. Alternatively, it may indicate a significant volume of erroneous or fraudulent claims.	Reliefs may be subject to error and fraud because: the relief is too complex for claimants to understand or open to interpretation; its design leaves it open to fraud or criminal attack; or because abusers perceive a low risk of being identified.
Impact	**Affordability:** Reduces the revenue available to spend on implementation of similar/other policy objectives. **Effectiveness:** Ineffective reliefs mean that the government may have foregone significant revenue for no benefit. **Wider impacts:** Creates unnecessary complexity in the tax system and diverts HMRC resources from more useful activities. May have a negative impact on government economic policies more generally. These impacts will be greater if there is delay in collating and identifying data, and in amending the relief once problems are identified.	**Affordability:** Tax revenue is reduced more than expected. **Effectiveness:** Costs may outweigh benefits from the relief (see risk of not meeting objectives). These impacts will be greater if there is a long time-lag before accurate cost data is available.	**Affordability:** Escalating costs due to processing of non-eligible claims. High administrative costs to tackle non-compliance. **Effectiveness:** Reducing the effectiveness of the relief. **Wider impacts:** Paying out or processing fraudulent claims may support criminal activity or undermine trust in the tax system. These impacts will be greater if there is a lack of timely and comprehensive management information to identify non-compliance.

Notes

1 This is a summary of main risks observed. It is not an exhaustive list, nor is it intended to illustrate the specific risks relating to each relief.

2 Data for most reliefs is only available with a two-year lag. Therefore, cost estimates for the current and previous year are based on internal forecasts and, in some cases, estimates based on third party sources.

Source: National Audit Office

Part Two

Understanding whether reliefs are meeting their economic objectives

2.1 Tax reliefs can play an important role in achieving government objectives. They can be more effective and may involve less administration than policies delivered through direct public spending. However, they are not risk free. Costs can rise quickly, and there is a risk that the relief may not have the desired impact on the recipient's behaviour, limiting the benefit.

2.2 It is therefore imperative that foregoing large sums of tax revenue through reliefs can be shown to be worthwhile. In July 2020 the House of Commons Committee of Public Accounts recommended HM Revenue & Customs (HMRC) "ensure that the results of internal, as well as external, evaluations are published, and are easily accessible to Parliament and the public".[8] In July 2023 the House of Commons Treasury Select Committee recommended that reliefs to be systematically reviewed to remove those that were ineffective and called for reliefs to be subject to the same level of scrutiny as public expenditure.[9]

2.3 In this part we consider HM Treasury and HMRC's approach to:

- monitoring the impact and cost of tax reliefs with economic objectives; and
- evaluating the effectiveness of reliefs with economic objectives, and using the results.

8 Committee of Public Accounts, *Management of tax reliefs*, Twelfth Report of Session 2019-21, HC 379, July 2020.
9 House of Commons Treasury Select Committee, *Tax Reliefs*, Twentieth Report of Session 2022-23, HC 723, July 2023.

Monitoring the impact and cost of tax reliefs with economic objectives

HMRC's approach to monitoring and reporting the costs of reliefs

2.4 HM Treasury and HMRC develop forecasts of the Exchequer impact when introducing or amending tax reliefs. Cost increases can mean that: a tax relief is achieving its desired objectives; a relief is being claimed inappropriately; or that the relief is being claimed without the desired change in behaviours. Uncertainties around taxpayer behaviour, and wider demographic or economic changes and policies mean careful analysis of the costs is necessary to help the departments and wider public understand whether tax reliefs are having the desired effect.

2.5 In 2021 HMRC started to publish an increasing number of cost estimates for reliefs. The latest version published in December 2023, and the January 2023 publication that preceded it, included some analysis of costs over time. In January 2023 HMRC identified that the costs of 42 out of 95 reliefs (44%) increased between 2017-18 and 2021-22, most by more than £50 million. It found that nearly a third of the cost of the 95 reliefs had remained more or less constant over the five-year period. In the December 2023 release HMRC estimated that 39 reliefs had increased by more than 10% between 2018-19 and 2022-23. HMRC published commentary explaining movements in costs for the 36 largest reliefs (costing more than £500 million a year). This public reporting does not include a meaningful comparison of outturn costs against forecasts.[10] Tax reliefs intended to achieve economic objectives may grow rapidly initially as taxpayers become aware of the reliefs and respond to the incentives provided, but these effects would normally taper off over time, subject to any subsequent changes to generosity or eligibility. The two reliefs with economic objectives that had the largest percentage change in cost over the last five years are among our case studies and we discuss these later in this part of the report.

Work to identify and understand cost movements

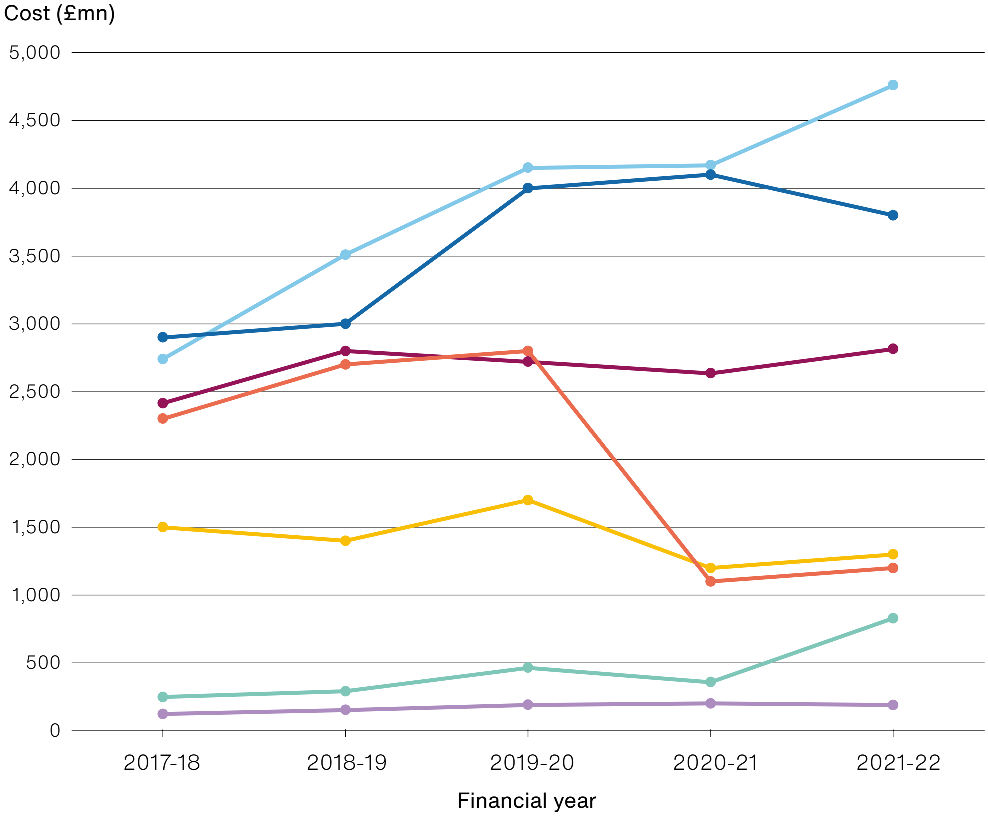
2.6 Where costs move significantly we expect HMRC to investigate the reasons for changes. We looked in more detail at how the costs varied from expectations for a sub-sample of tax reliefs with an objective to incentivise business investment, including many of those with the largest variations in cost. We considered the frequency of cost estimates, accuracy of forecasts and use of third-party data to look at trends. All of our case study tax reliefs had multi-year cost estimates available but not all had cost and claims estimates available over a longer period of time, limiting the depth of analysis possible (**Figure 6** on pages 30 and 31).

10 The latest release included a limited comparison of forecast against outturn for nine reliefs that had been introduced since 2010-11 where a forecast existed covering 2018-19 onwards. These had an annual cost of £2.6 billion in 2022-23. It did not include a comparison for amended reliefs or other reliefs.

Figure 6

Cost of case study tax reliefs, 2017-18 to 2021-22

In the five-year period from 2017-18 to 2021-22, the costs of our case study reliefs have fluctuated, varying greatly in magnitude and rate of growth



	2017-18	2018-19	2019-20	2020-21	2021-22
Research and Development (R&D) expenditure credit	2,415	2,800	2,720	2,635	2,815
Research and Development (R&D) tax relief for small and medium-sized enterprises	2,740	3,510	4,150	4,170	4,760
Annual Investment Allowance	2,900	3,000	4,000	4,100	3,800
First-year allowance for plant or machinery for oil and gas trades	1,500	1,400	1,700	1,200	1,300
Business Asset Disposal Relief	2,300	2,700	2,800	1,100	1,200
High-end Television Tax Relief	249	291	465	358	829
Video Games Tax Relief	124	153	191	201	189

Figure 6 *continued*
Cost of case study tax reliefs, 2017-18 to 2021-22

Notes
1 Values are in cash terms to align with HM Revenue & Customs' (HMRC's) own reporting of the numbers.
2 Our case study reliefs were sampled purposively from the population of non-structural tax reliefs, using criteria including: relief cost; whether the relief has been subject to abuse; payment mechanism; and the age of the relief.
3 HMRC estimates the past cost of the Research and Development reliefs using tax returns. The published cost represents the cost of allowance claimed as payable credits and the value of deductions made under the small and medium-sized enterprise scheme.
4 HMRC estimates the past cost of the oil and gas allowance using tax returns and expenditure estimates from the North Sea Transition Authority. The published cost represents the cost of allowance claimed.
5 HMRC estimates the cost of the Annual Investment Allowance (AIA) using tax returns. The published cost represents the cost of allowance claimed. The cost of AIA in 2021-22 was affected by the introduction of the capital allowance super-deduction, but HMRC is unable to quantify the impact. The super-deduction means that the profit on which a claimant's tax bill is based is arrived at after deducting the entire cost of the relevant plant and machinery, and an additional 30% of that cost.
6 HMRC estimates the cost of the Business Asset Disposal Relief (BADR) using tax returns. The published cost reflects the reduced tax liability arising from the individual paying Capital Gains Tax at the lower relief rate. The outturn cost of BADR reduced significantly in 2020-21 due to a reduction in the lifetime limit on qualifying gains from £10 million to £1 million.

Source: National Audit Office analysis of HM Revenue & Customs data

HMRC's approach to forecasting relief costs

2.7 Published forecasts and outturn costs often cannot be compared for individual reliefs for the following reasons:

- HM Treasury generally publishes a six-year forecast for a relief when it is introduced in its policy costings, using data supplied by HMRC and assumptions reviewed by the Office for Budget Responsibility (OBR).[11] This is the 'net Exchequer impact' of the relief on underlying tax revenues and is not directly comparable with outturn costs. This means that it estimates how much future revenues are expected to change based on the change introduced. These impact estimates form part of the policy costings produced alongside the budget and are not updated.
- Since the Exchequer impacts reflect a net position the best estimate of the forecast total cost of reliefs is the annual update provided to the OBR. HMRC told us that it produces this unpublished six-year forecast of tax revenue for the OBR each year which includes:
    - an estimate of the cost of corporation tax reliefs claimed as tax credits, including Research and Development (R&D) tax credits and total corporate tax credits; and

11 If a relief is amended through legislation, HM Treasury publishes the net impact of the changes on the current baseline cost, but this baseline cost will not be in the public domain.

  - an overall estimate of tax revenue from corporation tax, which takes into account reliefs claimed by taxpayers through amendments within their tax return. HMRC does not separately forecast the cost of these reliefs. For example, corporation tax is forecast net of capital allowances rather than splitting out the cost of capital allowances separately.

- Forecasts and outturn costs may also be presented on a different basis in different publications – sometimes on a receipts basis, sometimes as an effect on the tax liability.

Accuracy of HMRC's internal cost forecasts for our case study reliefs

Reliefs involving tax credit payments

2.8 Historically HMRC has underestimated the cost to the Exchequer of the R&D tax reliefs by wide margins. The small and medium-sized enterprise (SME) relief and the expenditure credit for large businesses cost around £15 billion more in cash terms between 2015-16 and 2020-21 than HMRC's 2014 policy costings indicated. Most of this growth was driven by the SME scheme. In October 2022 HMRC's own analysis of the SME relief covering 2015-16 through 2018-19 found that 74% of the growth during this period could not be explained by either relief rate changes or growth in the economy. HMRC told us that it believes most of this growth was due to increased take-up of the relief by eligible claimants due to greater attractiveness and awareness of the schemes.

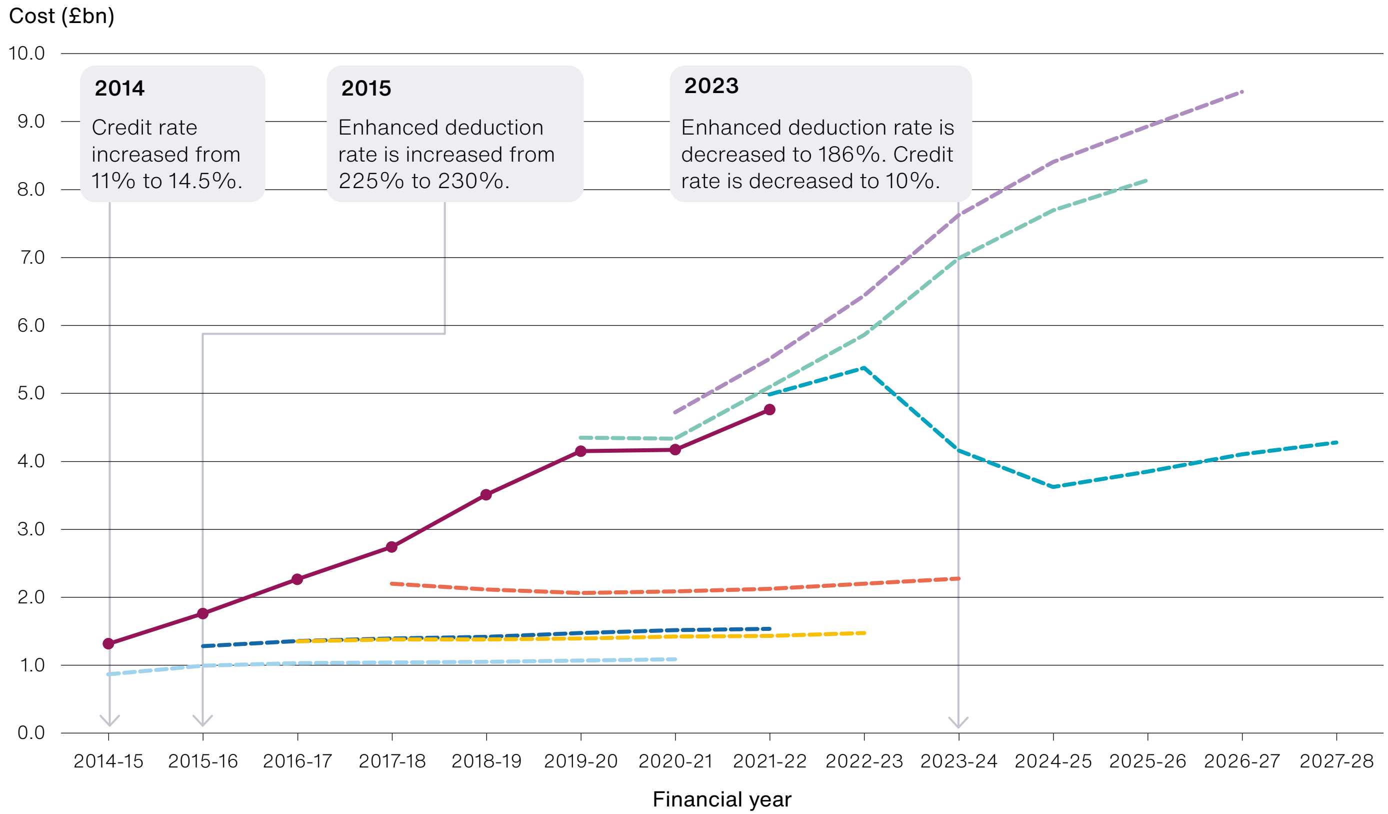
2.9 The unpublished six-year forecasts subsequently provided by HMRC to OBR each year have also consistently underestimated the real cost of the R&D reliefs, in particular the SME scheme (**Figure 7** on pages 33 and 34). For example, the initial 2016 SME scheme forecast produced for OBR expected the scheme to cost £6.3 billion in cash terms from 2015-16 to 2020-21. In practice the scheme cost £18.6 billion during this period, £12.3 billion (196%) more than expected.

2.10 HMRC has improved its forecasts since 2019 by refining growth assumptions, including accounting for pandemic impacts, and resolving issues with data coverage. The latest forecasts for spring 2023 included significant revisions to the expected cost as policy changes reduced the generosity of the SME scheme and increased the generosity of the scheme for large business.

Figure 7

Forecast and outturn cost of Research and Development (R&D) tax relief for small and medium-sized enterprises (SMEs), 2014-15 to 2027-28

Years of forecasts significantly under-estimated the cost of R&D relief for SMEs, until 2021



	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Actual cost	1.3	1.8	2.3	2.7	3.5	4.2	4.2	4.8						
Spring 2016 forecast	0.9	1.0	1.0	1.0	1.1	1.1	1.1							
Spring 2017 forecast		1.3	1.4	1.4	1.4	1.5	1.5	1.5						
Spring 2018 forecast			1.4	1.4	1.4	1.4	1.4	1.4	1.5					
Spring 2019 forecast				2.2	2.1	2.1	2.1	2.1	2.2	2.3				
Spring 2021 forecast						4.4	4.3	5.1	5.9	7.0	7.7	8.1		
Spring 2022 forecast							4.7	5.5	6.4	7.6	8.4	8.9	9.4	
Spring 2023 forecast								5.0	5.4	4.2	3.6	3.9	4.1	4.3

Figure 7 *continued*

Forecast and outturn cost of Research and Development (R&D) tax relief for small and medium-sized enterprises (SMEs), 2014-15 to 2027-28

Notes

1 HM Revenue & Customs (HMRC) provides annual forecasts for the Office for Budget Responsibility's (OBR's) fiscal forecasts. These estimate the cost of reliefs for the most recent two years and the coming five years.

2 Costs reflect the fact that OBR forecasts are in cash terms. They have therefore not been adjusted for inflation and numbers may differ from other reporting.

3 HMRC told us that forecasts prior to spring 2020 were subject to gaps in administrative data, and it has amended this in subsequent forecasts.

4 HMRC's spring 2020 forecast did not provide a breakdown between the Research and Development (R&D) expenditure credit (RDEC) and the SME scheme. This has therefore not been included in the chart.

Source: National Audit Office analysis of HM Revenue & Customs data

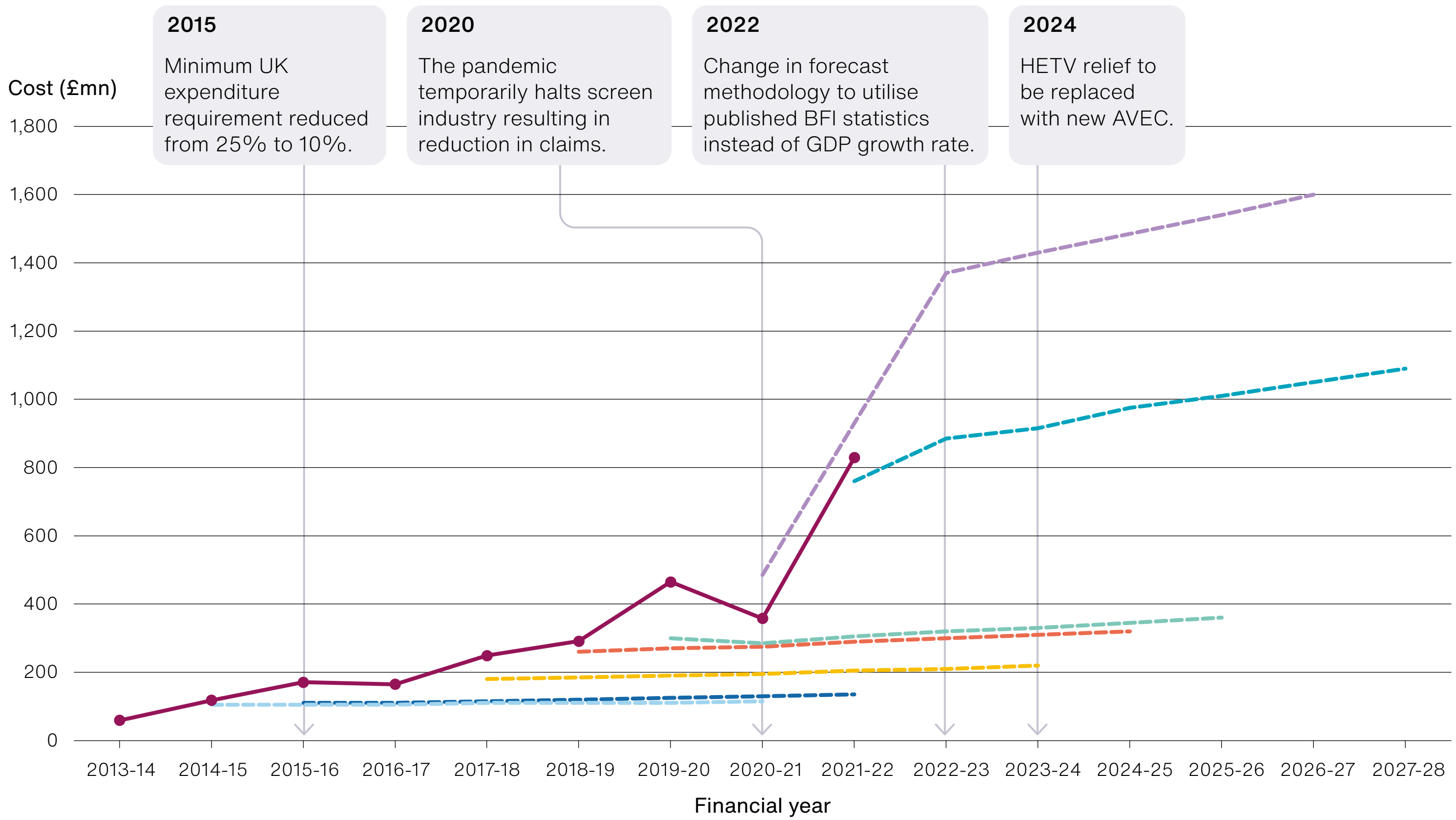
2.11 Other corporation tax credits have also cost significantly more than originally anticipated and subsequent forecasts produced by HMRC for OBR have significantly underestimated the costs (**Figure 8** on pages 35 and 36). In its initial policy costing at Autumn Statement 2012, HMRC estimated that High end Television (HETV) relief would cost £205 million from 2013-14 to 2017-18. Instead, the relief cost £762 million during this period (£557 million, or 272%, more). HMRC considers that this difference is due to a rapidly expanding HETV market and an expansion in scheme eligibility in 2015, but subsequent forecasts still repeatedly underestimated the growth. Similarly, when Video Games Tax Relief (VGTR) was announced HMRC estimated that the relief would cost £75 million from 2014-15 to 2016-17. In practice, VGTR cost £254 million during this period (£179 million, or 239%, more). Before the relief was introduced the eligibility criteria were expanded to include expenditure incurred within the European Economic Area (EEA) as well as the UK but HMRC did not update its policy costing to reflect this.

2.12 More detailed assumptions for targeted reliefs can improve the accuracy of the forecast. The forecasting methodology and assumptions differ between reliefs and HMRC does not always forecast the volume of claims. Instead, HMRC based the forecasts for R&D and creative reliefs on the OBR's estimate of future economy-wide investment and rate of nominal GDP growth. This assumes that businesses claiming each relief will not increase their activity at a faster rate than the average growth across all sectors of the economy, implicitly assuming reliefs would have no additional effect on growth. For example, in the case of HETV, HMRC adjusted its forecasting to use industry-specific growth rates from British Film Institute statistics.

Figure 8

Forecast and outturn cost of High-end Television (HETV) Tax Relief, 2013-14 to 2027-28

The cost of HETV relief was consistently higher than forecasts between 2016 and 2021, though a methodology change in 2022 has improved the accuracy of the forecast



	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Outturn cost	59	118	171	165	249	291	465	358	829						
Spring 2016 forecast		105	105	105	110	110	110	115							
Spring 2017 forecast			110	110	115	120	125	130	135						
Spring 2019 forecast					180	185	190	195	205	210	220				
Spring 2020 forecast						260	270	275	290	300	310	320			
Spring 2021 forecast							300	285	305	320	330	345	360		
Spring 2022 forecast								485	930	1,370	1,430	1,485	1,540	1,600	
Spring 2023 forecast									760	885	915	975	1,010	1,050	1,090

Figure 8 *continued*

Forecast and outturn cost of High-end Television (HETV) Tax Relief, 2013-14 to 2027-28

Notes

1 HM Revenue & Customs (HMRC) provides annual forecasts for the Office for Budget Responsibility's (OBR's) fiscal forecasts. These estimate the cost of reliefs for the most recent two years and the coming five years.

2 In 2015, HMRC also announced changes to the cultural test, administered by the British Film Institute (BFI), for HETV relief alongside the changes in minimum qualifying expenditure. These changes included awarding more points for productions in English or European languages.

3 HETV relief is to be replaced by the new Audio-Visual Expenditure Credit (AVEC) from 2024.

4 Costs reflect the fact that OBR forecasts are in cash terms. They have therefore not been adjusted for inflation and numbers may differ from other reporting.

5 HMRC did not produce a forecast for 2018.

Source: National Audit Office analysis of HM Revenue & Customs data

Reliefs that are self-assessed by claimants on their tax returns

2.13 For reliefs like capital allowances and Business Asset Disposal Relief (BADR) where claimants include the claim in their tax returns, HMRC estimates the net Exchequer impact of measures rather than producing forecasts that can be compared against outturn costs. However, initial impact estimates are not always readily available. For example, HMRC did not produce stand-alone initial forecasts for first year capital allowances for oil and gas (although it produces short-term internal forecasts) or BADR (then Entrepreneurs' Relief). The enhanced capital allowances for freeports were announced without an estimated cost because the location and size of tax sites was not known at the time of the announcement.

2.14 Forecasting in this area has some inherent difficulties. Lack of relief-level data means that HMRC may have to base forecasts on broad assumptions. For example, HMRC uses a model to project qualifying investment for every business that is eligible assuming that existing Annual Investment Allowance (AIA) claims will grow in line with national forecast capital investment. It also assumes all eligible businesses claim the maximum available. HMRC forecasts the amount of tax that will be collected from BADR-eligible disposals of financial and other property assets and imputes a value for BADR from that. A complicating factor for BADR is that claimants could claim the relief at any stage of their career, or on several occasions.

HMRC understanding of unexpected movements in costs

2.15 HMRC's published analysis of reliefs shows that the department has taken steps to better understand the reasons for cost movements. However, the detail and available sources that can be used as assurance differs between reliefs. In the case of R&D reliefs HMRC was still concluding as late as 2020-21 that the increases above forecast were due to unexpectedly high take-up by eligible claimants on grounds of increased attractiveness and awareness. There was a significant discrepancy between HMRC and Office for National Statistics (ONS) figures for R&D expenditure, for which an initial adjustment was not made until 2022 when ONS amended its estimates of R&D activity because of under-sampling of small and medium-sized companies. ONS intends to publish data using the revised sampling approach in 2024. HMRC told us that it would have needed a random enquiry scheme like the 'mandatory random enquiry programme' (MREP) to identify the likely levels of non-compliance. This is discussed in more detail in Part Three.

2.16 Where possible, HMRC reviews relief costs against trends from other data. For our case studies, we saw triangulation with third party data for the R&D and creative reliefs, and the first-year allowance for oil and gas. It provided assurance that changes in the cost of these reliefs were explainable by wider industry changes, with the exception of the R&D SME relief.

HMRC's monitoring and evaluation of whether economic objectives are achieved

2.17 Evaluations are crucial for understanding whether tax reliefs are meeting their objectives. In response to Committee of Public Accounts (PAC) recommendations HMRC developed an evaluation framework in 2021 to deliver proportionate and systematic monitoring of policies, programmes and projects in line with government good practice. In this section we consider:

- HMRC's progress evaluating non-structural tax reliefs;
- what evaluations to date tell us about the effectiveness of non-structural reliefs;
- how the departments have responded to the findings from evaluations; and
- HMRC's plans to improve the quality and timeliness of evaluations.

HMRC's progress evaluating non-structural tax reliefs

2.18 The timeliness of evaluations varies substantially. Tax measures to encourage economic growth do not have a statutory timetable for review or reassessment. We have seen examples where evaluations have been undertaken promptly after a relief was introduced. However, in other cases evaluations are not promptly conducted. Annual Investment Allowance (AIA) was evaluated in 2022, 14 years after the relief was introduced. During this time HM Treasury had made eight changes to the maximum amount claimable. Although the work was done in 2022 the evaluation has yet to be published.

2.19 Since 2015 HMRC has published 14 evaluations covering 25 non-structural tax reliefs (22 of which have an economic objective). This includes two evaluations published since 2021, covering four creative reliefs and three share investment schemes. Taken together, the summed annual cost of reliefs evaluated since 2015 is £22.4 billion (based on 2022-23 costs) or 11% of the total cost of non-structural reliefs in that year. HMRC has plans to publish a further 10 evaluations covering 20 non-structural reliefs, 11 of which have not previously been evaluated. HMRC's evaluation plans include significant new economic measures such as the capital allowance super-deduction and UK freeports.

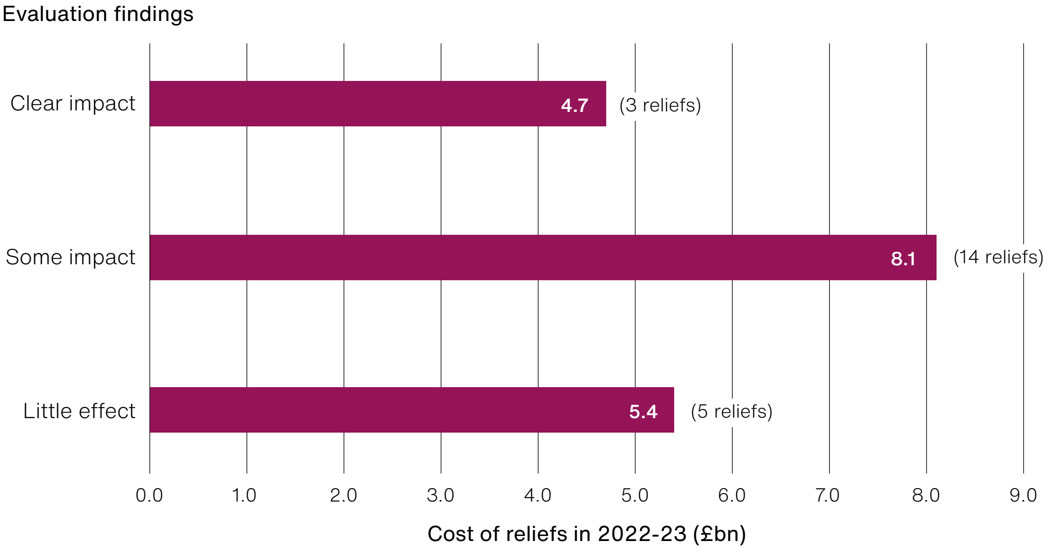
Evaluation findings

2.20 HMRC's evaluations have found that reliefs vary substantially in terms of their effectiveness. HMRC found at least some impact on economic activity for 17 out of 22 reliefs with an economic objective (costing £12.8 billion in 2022-23). The remaining five reliefs (£5.4 billion in 2022-23) were found to have limited impact on economic activity (**Figure 9**). Only a minority of the evaluations quantified the additional economic activity generated. Evaluations of the Research and Development (R&D) expenditure credit (RDEC) and of the HETV and Film Tax reliefs found that the reliefs created additional economic activity by an amount higher than the cost of the relief. The R&D SME relief did not show clear evidence of impact, and the impact was less than the value of the relief where credit payments were made to companies. For most of the other reliefs evaluated HMRC tended to rely on the views of taxpayers receiving the reliefs to understand whether it affected their behaviour. It used quantitative analysis where the taxpayer population was sufficiently large to support such analysis.

Figure 9

Evaluation findings and cost (in 2022-23) of non-structural tax reliefs with economic objectives evaluated since 2015

Five of the 22 non-structural reliefs with economic objectives evaluated since 2015 have been found to have limited impact – these reliefs cost £5.4 billion in 2022-23



Notes

1 HM Revenue & Customs' (HMRC's) tax relief evaluations are either carried out by HMRC analysts or commissioned from external organisations. In general, evaluations aim to determine if reliefs are achieving their stated objectives.

2 Evaluation findings are classified as follows:

- Clear impact: the relief was found to increase economic activity by an amount higher than the cost of the relief.
- Some impact: the relief was found to increase economic activity, but it is unclear if this is by an amount higher than the cost of the relief.
- Little effect: the relief was found to have limited effectiveness at increasing economic activity.

3 The reliefs found to have clear impact were: Research and Development (R&D) expenditure credit (RDEC); High-end Television Tax Relief; and Film Tax Relief.

4 The reliefs found to have some impact were: R&D tax relief for small and medium-sized enterprises; Enterprise Investment Scheme (EIS) Disposal Relief; EIS Income Tax Relief; EIS Deferral Relief; Venture Capital Trusts (VCTs) Disposal Relief; VCTs Income Tax Relief; VCTs dividends exemption; Video Games Tax Relief; Children's Television Tax Relief; Animation Tax Relief; Approved Company Share Option Plans; Share Incentive Plan; Patent Box Relief; and Save As You Earn.

5 The reliefs found to have little effect were: Business Asset Rollover Relief; Business Asset Disposal Relief; Employment Allowance; Relief on employer National Insurance Contributions (NICs) for apprentices under 25; and Relief on employer NICs for employees under 21.

6 The cost figures are in cash terms to align with HMRC's reporting.

Source: National Audit Office analysis of HM Revenue & Customs data

Responding to evaluation findings

2.21 Ministers decide whether to amend a relief, having taken HM Treasury's advice. HM Treasury told us ministers may take into account a wider range of factors including wider government objectives, the priorities of each fiscal event, levels of Parliamentary support, and public perception. Evaluation findings have led to policy changes for two of the five economic reliefs found to have limited effectiveness: Business Asset Disposal Relief (BADR) and Employment Allowance. The departments have also made changes in part informed by evaluation findings for the R&D relief schemes. In each case, the changes have led to savings or additional revenue for the Exchequer.

Business Asset Disposal Relief/Entrepreneurs' Relief

2.22 Entrepreneurs' Relief (ER, now renamed BADR) was evaluated in 2015 and 2017 through externally commissioned surveys and interviews. The cost of the relief greatly exceeded expectations and more than doubled in cash terms (to over £4 billion) from 2012-13 to 2015-16.[12] The evaluation published in 2017, for which fieldwork took place in 2016, found that only 8% of ER beneficiaries reported that the relief had influenced their decision to invest, and therefore the relief did not meet its objective of driving entrepreneurial activity.

2.23 When providing advice on the relief, HM Treasury put forward options for its reform or abolition. The advice set out the evaluation findings and pointed out the criticism of the cost and impact of the relief by a range of other bodies, including the NAO. Cost estimates for setting eligibility at different thresholds were set out. In the event ministers chose the option to reduce the lifetime allowance from £10 million to £1 million. The change was introduced in 2020-21 – three years after the evaluation of the relief – although HMRC told us that there had been periodic discussions with ministers during that time. Since then, the annual cost of the relief has fallen by £1.6 billion (57%) in cash terms. HMRC has an internal evaluation of the revised relief underway.

Research and Development relief for small and medium-sized enterprises

2.24 Evaluation evidence indicated that R&D relief for SMEs was considerably less effective than the RDEC scheme for large companies.[13] HMRC published an externally commissioned evaluation of R&D tax relief for SMEs in November 2020 based on fieldwork conducted in 2019. This concluded that the amount of additional R&D expenditure stimulated for every £1 of relief was between £0.75 and £1.28 in the case of a claim for a profit-making SME and between £0.6 and £1 for a claim from a loss-making SME. The SME evaluation also found that recent changes to the relief were having less impact. Lack of knowledge of the high levels of error and fraud on the relief meant this was not included in the analysis.

12 A change to the rates of Capital Gains Tax in 2016-17 reduced the value of the relief but claims started to rise again thereafter.

13 SMEs can under some circumstances claim this relief as well.

2.25 Proposed changes to the schemes were announced two years after the evaluation was published and three years after fieldwork. In November 2022, HM Treasury put forward options to reduce the rates for R&D relief for SMEs (and increase the rates for RDEC), citing evaluation evidence and widespread abuse of the SME scheme. HM Treasury implemented these changes, reducing the rates of the SME relief and increasing the RDEC rate from April 2023. It forecasts that the net effect of changes to both reliefs will reduce their costs by £4.5 billion between 2023-24 and 2027-28.

Employment Allowance

2.26 The objective of the Employment Allowance relief is to support small businesses and charities by reducing the cost of employment. HMRC published an evaluation of the relief in 2015 which concluded that the allowance was having a limited impact on businesses' spending decisions. Fieldwork was conducted in 2014. At Budget 2018, the government announced that from April 2020 Employment Allowance would be restricted to employers with a total National Insurance Contributions (NICs) liability of less than £100,000 in the previous year. It forecast that this change would generate an additional £1.1 billion of revenue for the Exchequer between 2018-19 and 2023-24.

Reliefs where no changes have been made

2.27 The remaining three reliefs where the evaluation concluded that the relief had limited impact on economic activity – Business Asset Rollover Relief (published 2015),[14] relief on employer NICs for employees under 21 and Relief on employer NICs for apprentices under 25 (both published 2018) – have not been subject to any changes or amendments, despite the evaluations being published over five years ago. Reliefs that do not achieve their economic objectives are costly The reduced National Insurance Contributions (NICs) for under-21s was estimated to cost £850 million in 2022-23, and the relief on NICs for under-25s £290 million. No cost estimate was available for the Business Asset Rollover Relief. The faster that revisions can be made, the greater the opportunity to improve outcomes and reduce costs to the Exchequer.

Opportunities to improve the quality and timeliness of evaluations

2.28 HMRC has taken steps to improve the quality and timeliness of the evaluation of tax reliefs. HMRC produced an evaluation framework specifically for tax reliefs in December 2021. The plan includes criteria on how to identify reliefs suitable for evaluation. Importantly HMRC will now ensure as far as possible that all its evaluations explore the impact of the relief, claimant and non-claimant awareness, the process of claiming the relief, whether the level of relief is proportionate, and whether a relief is the appropriate mechanism for support. Both of HMRC's evaluations published since 2021 have covered these points.

14 This relief applies when purchasing new assets with proceeds from the sale of business assets.

2.29 Evaluations have saved the Exchequer billions of pounds but spending on them is falling in 2023-24. HMRC's spending on tax relief evaluations now has a dedicated budget. In the past three years HMRC has dedicated an average annual budget of £797,000 for evaluating reliefs in cash terms. HMRC went from spending £427,000 on all its evaluations in 2018-19 to spending £1.1 million on evaluations of reliefs alone in 2022-23, but this is planned to fall to £600,000 in 2023-24.

2.30 Other government bodies increase their evaluation capacity by publicising their areas of interests for researchers to explore but HMRC does not currently do this. Stakeholders suggested HMRC could do more to use the resources of other institutions and academia to make the most of the data available and research interests. HMRC has set up a 'datalab' – a physical space in one of HMRC's London offices – to host data securely and make it available for accredited researchers to carry out research relevant to HMRC's interests. Researchers told us of long waits for research applications to be considered, a lack of clarity around the prioritisation of research projects and data-sharing arrangements, and the unavailability of current data. Academics we spoke to said that it was difficult to engage with HMRC. HMRC closed the datalab during the pandemic and gradually reopened it during 2022. HMRC is now taking steps to address many of the issues raised with us. It has upgraded IT facilities, restored resourcing to pre-pandemic levels, made available more current data, is speeding up its processing of new data access requests, and is recruiting a research engagement lead. It is also considering options to expand access by opening additional sites and providing secure remote access. A number of research projects are looking at tax reliefs, including R&D tax credits.

Part Three

Managing the risk of error and fraud in non-structural reliefs

3.1 Error and fraud increase the cost of reliefs, including the resources that HM Revenue & Customs (HMRC) needs to administer them, and undermines their effectiveness. Tax reliefs that are generous in nature, such as those resulting in payments, are believed to be attractive to fraudsters. For example, we have reported that a previous iteration of Film Tax Relief and share loss relief were targets for abuse in the early 2000s. More recently HMRC has found widespread abuse of the R&D tax reliefs.

3.2 This part examines:

- the level of risk associated with tax reliefs and HMRC's approach to tackling non-compliance;
- the potential scale of error and fraud in the Research and Development (R&D) tax relief for small and medium-sized enterprises (SMEs);
- lessons from R&D error and fraud and HMRC and HM Treasury's response;
- HMRC's management of the risk of error and fraud for other reliefs involving credit payments; and
- HMRC's compliance work where reliefs are claimed in tax returns.

HMRC's strategic approach to managing the risk of non-compliance

3.3 Each year HMRC carries out an assessment of the main risks to the tax system. As at 2022 it consisted of 63 current and emerging risks that could meet one of the following criteria within two years: the potential to reach a total financial impact of £250 million;[15] the potential to cause reputational damage to HMRC and/or the government; and the potential to cause severe social and/or economic harm to the country. Around a quarter of these risks (15) relate wholly or partly to tax reliefs. For each risk, HMRC produces a risk treatment plan.

15 This is what HMRC calls the 'gross' financial impact; it comprises the tax lost as well as compliance yield.

Responding to error and fraud in the R&D schemes

3.4 The UK has offered generous tax incentives to companies to invest in R&D since 2000. Large companies (and SMEs employed as sub-contractors for R&D purposes) can claim a credit payment equivalent to a set percentage of R&D expenditure under the R&D expenditure credit (RDEC) scheme.[16] Profitable SMEs can deduct up to 186% of their R&D costs from their tax return under the parallel SME scheme. If the company records a loss after the deduction it can surrender some or all of this loss to claim a credit payment.

3.5 The RDEC and SME schemes have both grown substantially in number and cost of claims since their introduction. The cost of the RDEC scheme increased by 201% in cash terms from 2013-14 to 2018-19 but has levelled off since then (**Figure 10**). The R&D scheme for SMEs has increased in cost by nearly 575% in cash terms from 2013-14 to 2021-22 (**Figure 11** on page 46) when it cost £4.76 billion. This partly represents inflation and increased tax revenue. However, even if the costs are adjusted for inflation the growth is substantial – 180% for RDEC and 479% for the SME scheme. The overall tax revenue also grew much less (45% from 2013-14 to 2021-22). A timeline of the changes made to eligibility and attractiveness of the reliefs and how concerns about error and fraud grew is shown in **Figure 12** on pages 47 and 48.

Emerging scale of error and fraud

3.6 HMRC conducts some form of risk assessment as part of the initial processing of all claims but has now established that this did not detect high levels of error and fraud on the R&D SME relief. From 2017 and 2018 HMRC identified more tax at risk from poor-quality R&D claims, and from abuse by companies with a limited UK presence, but it took several years for it to establish a realistic assessment of the risk of error and fraud on the SME relief, prompted by NAO recommendations. We qualified HMRC's financial statements from 2019-20 onwards due to the level of error and fraud on the schemes (estimated at 3.6% of R&D tax relief expenditure in 2019-20 and 2020-21).[17] In response to one of our recommendations, HMRC started a 'mandatory random enquiry programme' (MREP) from December 2020 to investigate around 500 claims a year on top of its standard compliance work. It reported the early results from this work in July 2023,[18] retrospectively increasing its estimate of the most likely level of error and fraud on the SME relief in 2020-21 from 5.5% of expenditure (£0.3 billion) to 24.4% (£1.04 billion). HMRC found 50% of 2020-21 claims it checked included an element of non-compliance. HMRC does not plan to restate the estimate for 2019-20. In response to these findings HMRC has taken steps to improve its up-front risk assessment processes for claims, which are set out in **Figure 13** on pages 48 and 49.

16 SMEs can under some circumstances claim this relief as well.

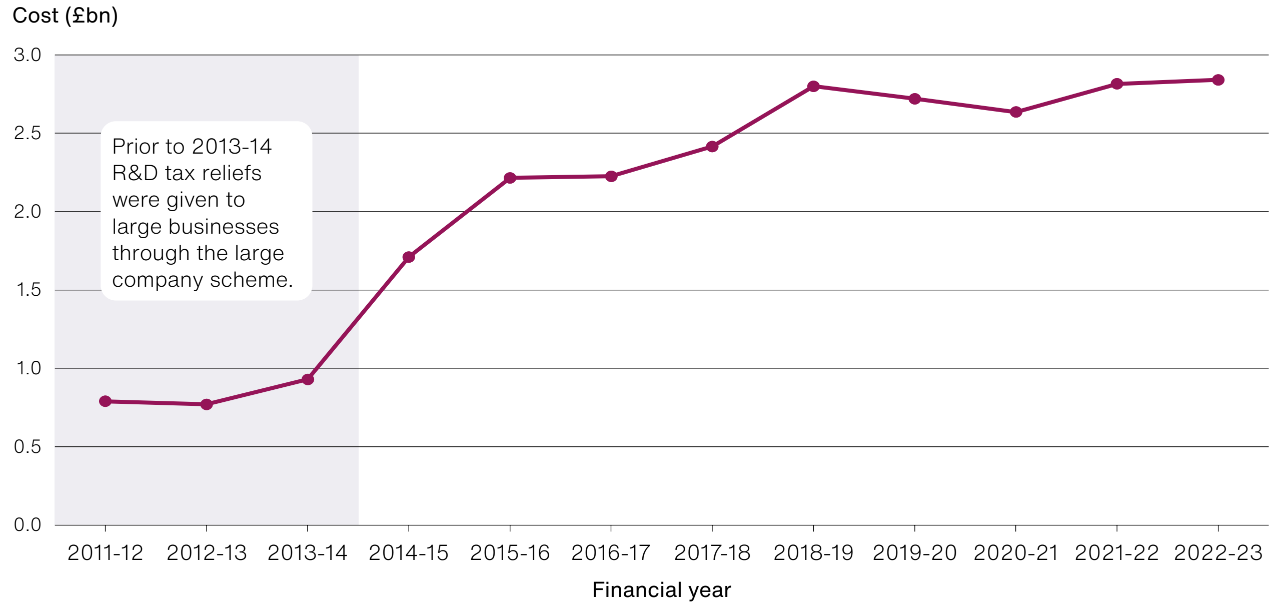
17 Comptroller and Auditor General, *Report by the Comptroller and Auditor General: HM Revenue & Customs 2022-23 Accounts*, National Audit Office, July 2023. Published in HM Revenue & Customs, *Annual Report and Accounts 2022 to 2023*, HC 1466, July 2023.

18 HM Revenue & Customs, *Annual Report and Accounts 2022 to 2023*, HC 1466, July 2023.

Figure 10

Cost of the Research and Development (R&D) expenditure credit (RDEC), 2011-12 to 2022-23

The cost of the RDEC scheme increased by around 245% in cash terms from 2011-12 to 2019-20



	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Cost	0.8	0.8	0.9	1.7	2.2	2.2	2.4	2.8	2.7	2.6	2.8	2.8

Notes

1 Values are in cash terms to align with HM Revenue & Customs' (HMRC's) reporting of the figures.

2 The Research and Development (R&D) scheme for large companies was introduced in 2002 as the 'large company scheme'. It was replaced by the RDEC scheme with the introduction of the 10% 'above the line' credit in 2012-13.

3 Costs from 2011-12 to 2021-22 are based on HMRC's September 2023 R&D tax credit statistics. Cost figures for 2020-21 and 2021-22 are provisional and could be revised in future years.

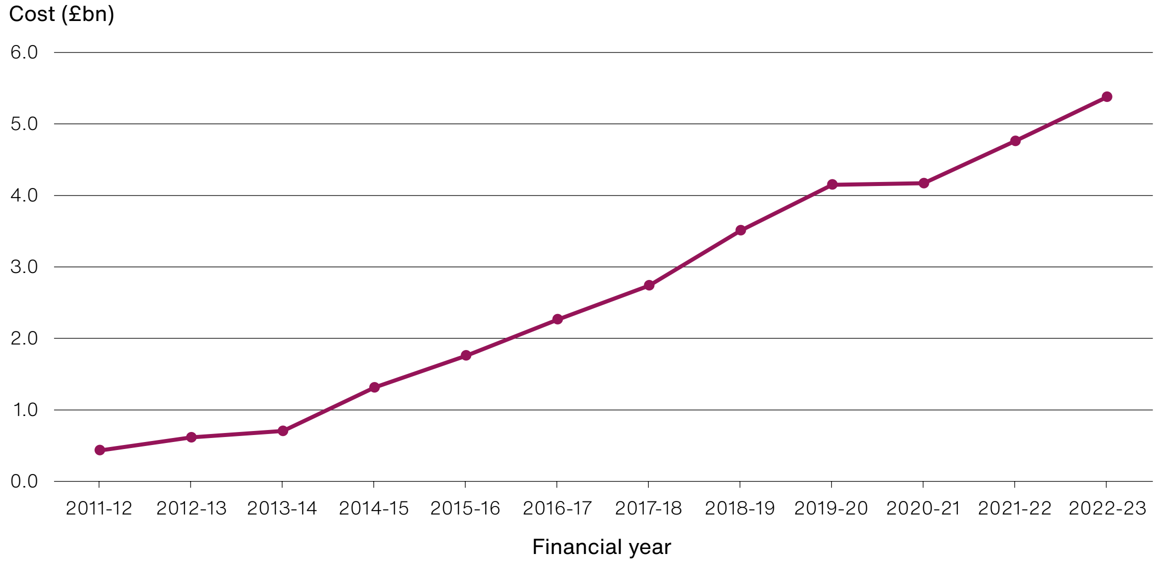
4 2022-23 costs are taken from HMRC's spring 2023 forecast provided to the Office for Budget Responsibility.

Source: National Audit Office analysis of HM Revenue & Customs data

3.7 While the MREP has provided a more realistic assessment of the scale or error and fraud on the scheme, the cumulative level of error and fraud for the years before the MREP is still not clear. HMRC is continuing the MREP to cover 2021-22. The approach for future years will be considered by HMRC annually and subject to review by the NAO as part of the audit of HMRC's financial statements. Alongside this activity HMRC increased risk-based enquiries by 627% in 2022-23. In 2022, in response to organised criminal attack, HMRC's Fraud Investigation Service (FIS) started a scheme to target around 2,500 claims that were identified as high risk, asking claimants to provide basic evidence such as proof of existence of the company and employees. FIS challenged claims of over £100 million and of these blocked payments worth £85 million, with only 3% of claims ultimately being paid in full.

Figure 11
Cost of Research and Development (R&D) tax relief for small and medium-sized enterprises (SMEs), 2011-12 to 2022-23

The cost of the R&D scheme for SMEs grew by around 850% in cash terms from 2011-12 to 2019-20



	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Cost	0.4	0.6	0.7	1.3	1.8	2.3	2.7	3.5	4.2	4.2	4.8	5.4

Notes

1 Values are in cash terms to align with HM Revenue & Customs' (HMRC's) reporting of the figures.

2 The SME scheme was introduced in 2000-01.

3 Costs from 2011-12 to 2021-22 are based on HMRC's September 2023 R&D tax credit statistics. Cost figures for 2020-21 and 2021-22 are provisional and could be revised in future years.

4 2022-23 costs are taken from HMRC's spring 2023 forecast provided to the Office for Budget Responsibility.

Source: National Audit Office analysis of HM Revenue & Customs data

Figure 12

Research and Development (R&D) tax reliefs key events, 2011 to 2023

R&D tax reliefs were subject to nine changes in rate between 2011 and 2023

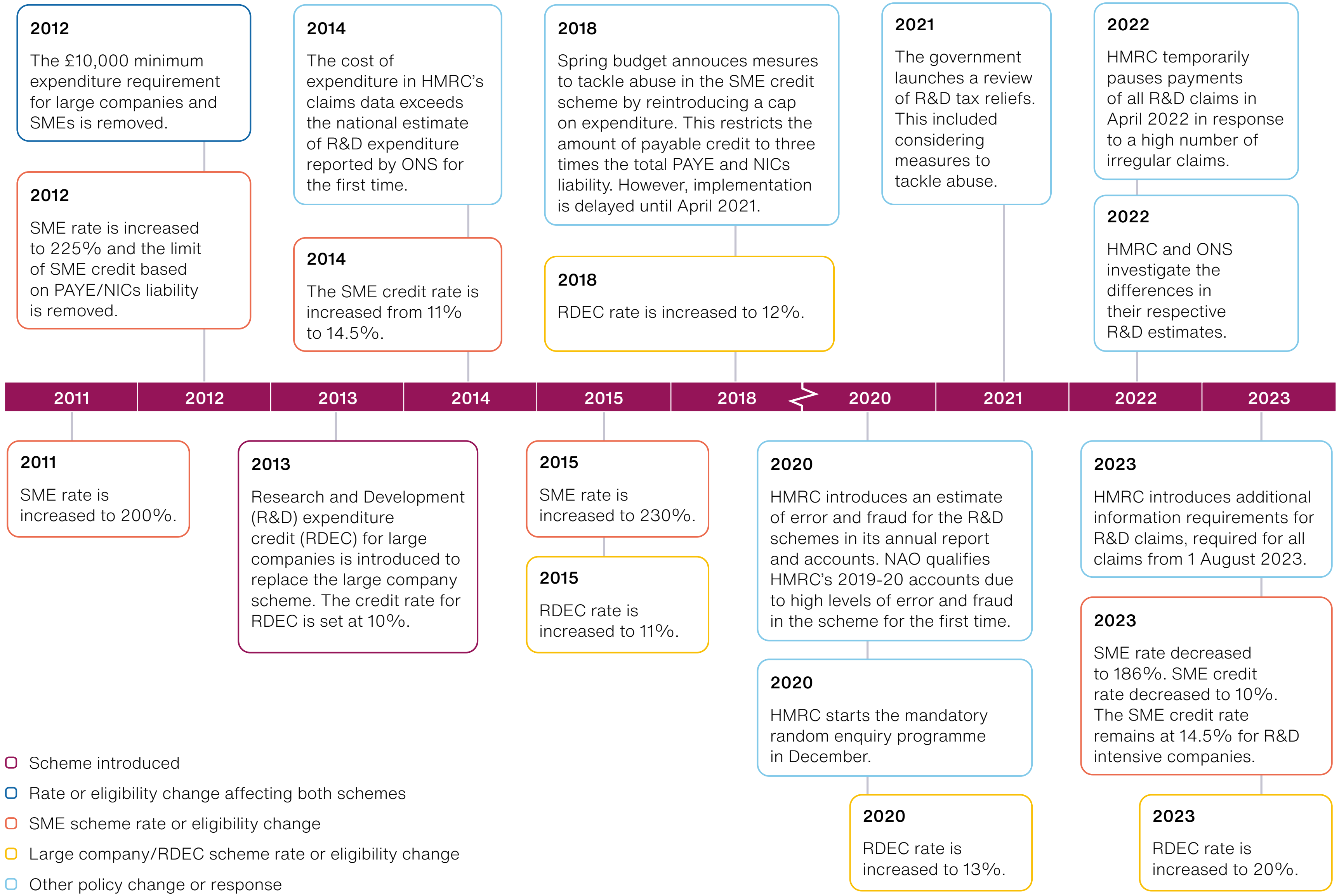


Figure 12 *continued*

Research and Development (R&D) tax reliefs key events, 2011 to 2023

Notes

1 Acronyms used throughout the graphic: HMRC – HM Revenue & Customs; NAO – National Audit Office; ONS – Office for National Statistics; SME – small and medium-sized enterprise; PAYE – Pay As You Earn; NICs – National Insurance Contributions.

2 R&D relief for SMEs was introduced in 2000. R&D relief for large companies was introduced in 2002.

3 The reliefs have both been subject to a number of changes in the years considered. This chart sets out key changes to rates and eligibility alongside actions taken by the government and is not exhaustive.

4 HMRC currently defines R&D intensive companies as companies where qualifying R&D expenditure is 40% or more of its total expenditure. From April 2024 this threshold will reduce to 30%.

Source: National Audit Office analysis of HM Revenue & Customs and Office for National Statistics guidance

Figure 13

Lessons from the administration of the Research and Development (R&D) relief for small and medium-sized enterprises (SMEs) and actions taken in response

Lessons can be learned from the challenges delivering the R&D reliefs. HM Revenue & Customs (HMRC) has taken action in response but there is scope to go further

Lesson	Actions taken
The need for accurate risking of reliefs. Since HMRC's assessment of the level of error and fraud was based on the findings of limited amounts of post-payment compliance work, this led to HMRC significantly underestimating the risk, which in turn undermined the case for increased compliance work.	HMRC has used a mandatory random enquiry programme (MREP) to produce a better assessment of the risk of error and fraud in the population of claims by testing R&D SME claims irrespective of whether they were previously judged as risky. HMRC also introduced new reporting requirements in August 2023 to get more data on R&D activity, expenditure, agent behaviour and business contacts. HMRC told us that it has designed a new set of automated validation rules to risk these claims.
The need for better forecasting of the level of take-up. The number of SME claims increased by 478% from 13,140 in 2012-13 to 75,940 in 2020-21 as successive changes made the relief more attractive to genuine claimants and ineligible claimants alike.	After a number of years of forecasts failing to adequately predict relief costs, HMRC changed its forecasting approach for R&D and creative reliefs to more realistically reflect demand for the schemes.
The need to maintain a strong financial control environment built around up-front checks. Until 2022, HMRC had a commitment to process 95% of claims within 28 days. This approach, termed 'process now, check later' by HMRC, was applied to all corporation tax self-assessment returns. Although all claims were risk-assessed to some degree, the scope for this was limited because of the limited data provided with returns. Only the claims identified as high risk by HMRC were checked by an officer pre-payment.	In 2022 HMRC gave itself more time to check claims – the target is now to approve 85% of claims within 40 days. In August 2023 HMRC started to develop a new approach to the management of reliefs based on credit payments. HMRC published proposals to improve controls around payment of the relief in 2021. After carrying out consultation on the proposals HMRC introduced improvements in two phases: • from 1 April 2023, first-time claimants and companies who have not claimed R&D tax relief for more than three years are not able to claim relief if they have not notified HMRC of their intention to do so within 6 months of the period end; and • from August 2023 businesses have had to submit claims digitally, include more detail with the claim, and have the claim endorsed by a named senior officer of the company.

Figure 13 *continued*

Lessons from the administration of the Research and Development (R&D) relief for small and medium-sized enterprises (SMEs) and actions taken in response

Lesson	Actions taken
The need to respond quickly to changing circumstances. Responsive compliance work is more expensive than preventative controls. However, it is needed when the level of error and fraud is high. HM Treasury and HMRC had not envisaged additional resources would be needed when the schemes were made more generous and minimum requirements for expenditure and payroll were lifted. HMRC had previously stated that it takes around 18 months to train new compliance officers and around four years for them to reach full productivity due to the training and experience required in these roles.	HMRC registered an increased risk of error and fraud on the relief in 2017 and 2018. In the 2018 budget the government announced a cap on the amount of relief claimable, that was not introduced until 2021. Other mitigating actions to address error and fraud were announced in 2021, but not introduced until 2023 (see above). Staff working risk-based compliance cases increased by around 230% in 2022-23, with 289 full-time equivalent staff instead of 88 the year before (not counting staff working on the MREP). The number of cases opened increased by 627%. This included a mix of experienced compliance officers and those who were trained but needed to build practical experience.
The need to remove the influence of rogue agents. Around 90% of R&D claims involve an agent. While many are reputable tax advisers, unaccredited 'agents' aggressively target potential claimants of R&D reliefs and market themselves to small businesses on the basis that far more business activity was eligible for the relief than was the case, and payments would not be checked. The problem is particularly acute with the smallest claims. In 2020-21 HMRC levied penalties on claimants of the relief for 'failure to take reasonable care' on 36 occasions, and only levied the full penalty 22% of the time.	HMRC updated its guidance for agents in February 2023, placing more obligations on agents for all types of relief to collaborate with HMRC and clients and to report suspicious activity. From August 2023 businesses are required to notify HMRC of any agents involved in R&D claims. In 2022-23 HMRC levied 370 penalties, 69% in full.
The need for a clear definition of a relief to minimise scope for erroneous claims. The R&D schemes use a definition of R&D based on the Income Tax Act 2007 and accompanying guidelines issued by the Department for Science, Innovation and Technology, but understanding whether claims are eligible may require detailed technical knowledge, and the wording of guidance leaves scope for subjective interpretation of concepts such as whether a problem could be 'readily' solved by a 'competent professional'. HMRC could not provide details on the number of experienced R&D staff in post over time.	In August 2023 HMRC undertook to: offer more training to inexperienced caseworkers; review the HMRC manual which sets out the rules applying to claims; and develop further guidance to help claimants be compliant. On 31 October 2023 HMRC published updated guidance for claimants on how to determine if they are eligible for the relief, including providing more detail on the role and definition of 'competent professionals' in claimants' businesses.

Note

1 The term 'process' covers both payment of eligible claims and the opening of compliance work on claims that have been assessed as risky.

Source: National Audit Office analysis of HM Revenue & Customs data

3.8 Non-compliance is a significant issue on the SME scheme both for claims paid as tax credits and as enhanced corporation tax deductions by businesses from their tax returns. HMRC sees tax credits as more attractive to fraudsters, but self-deductions from business tax returns are equally prone to error – the MREP found that 54% of self-deductions from business tax returns were non-compliant compared with 50% of claims for tax credits.

3.9 The sharp increase in the level of compliance work carried out by HMRC on R&D relief claims has caused widespread disquiet among claimants and their representative bodies about HMRC's approach, particularly a perception that claimants are viewed as suspicious and the use of some caseworkers with little experience in the area. Stakeholders raised particular concerns about:

- HMRC caseworkers' lack of familiarity with, and selective application of, HMRC's guidance on the scheme;
- the lack of expertise in the areas of science and technology covered by claims; and
- the 'volume approach' taken on smaller claims characterised by a reluctance to engage with claimants to discuss disputed claims.

3.10 In January 2023 the House of Lords Economic Affairs Finance Bill Sub-Committee commented on the need for more support for claimants of the R&D reliefs and found that HMRC is failing to meet its own charter which requires it to ensure that officers dealing with a taxpayer have the right level of expertise.[19] The Chartered Institute of Taxation (CIOT) wrote to HMRC in July 2023 setting out members' concerns in detail. In response, HMRC stated that the scale of the issue meant that it was "inevitable that the reforms and operational action required to tackle the problem would have an impact on compliant claimants". Although HMRC told us that caseworkers receive training and support it acknowledged when responding to CIOT that in some instances HMRC's response had not met its professional standards and Charter commitments and promised to take corrective actions as set out in Figure 13. HMRC also told us that it is developing an improvement plan with stakeholders to ensure Charter commitments are met.

Lessons from HMRC's administration of the R&D SME relief and actions taken in response

3.11 There were a range of factors that created the conditions for widespread error and fraud around this particular relief. In Figure 13 we identify the main lessons that have emerged from HMRC's administration of the R&D SME relief and actions taken by HMRC and HM Treasury in response.

19 House of Lords Economic Affairs Committee, *Research and development tax relief and expenditure credit*, Third Report of Session 2022-23, HL Paper 137, January 2023.

HMRC's management of the risk of error and fraud in other reliefs involving credit payments

3.12 HMRC has not carried out a wider lessons learned exercise from its experience of the R&D SME relief to consider the implications for its compliance approach more generally. In August 2023 HMRC developed an aspirational list of steps it could take to implement better repayment controls, which it refers to as a control framework. The framework sets out its future compliance approach to reliefs where claimants currently make a separate claim for a tax credit but it contains little detail on how this will be done in practice. HMRC will encourage its directorates to put forward plans for interventions, especially digital initiatives, to: support accurate submissions by claimants (including through external communications); improve risking and management of claims before payment; and develop targeted activities aimed at risky claims post-payment. It has not set timescales or other performance indicators around this framework.

3.13 In addition to corporation tax credits for R&D, the UK also offers tax credits to the creative industries. Collectively these cost £1.7 billion a year, and the cost has been growing. Even so there are relatively few claims for these reliefs compared with the R&D schemes. For example, taxpayers made 710 claims for High-end Television (HETV) Tax Relief and Video Games Tax Relief (VGTR) combined versus 75,940 for the R&D SME scheme in 2020-21. This allows more in-depth checking to be done before payment of any claims. The British Film Institute (BFI) certifies that a project meets the eligibility criteria by qualifying as British under a cultural test, or in the case of film and television as an official co-production. After examining relevant documentation the BFI issues an interim or final certificate to eligible applicants, allowing them to make a claim from HMRC. HMRC decides whether to accept or reject the claim. In 2021-22, HMRC rejected 19% of claims for VGTR and 2% of claims for HETV relief. However, HMRC told us that a "significant proportion" of rejected VGTR claims are successfully resubmitted and subsequently paid out. HMRC has a similar relationship to the BFI with the Intellectual Property Office regarding the triangulation of data on claimants for the Patent Box relief.

3.14 For these reliefs there is significantly more pre-payment checking than for the R&D schemes. Prior to payment a specialist unit at HMRC checks all claims' paperwork for BFI approval and completeness before manual risking of individual claims which may result in a compliance enquiry. Since 2018-19, HMRC has opened significantly more compliance investigations relating to VGTR claims than HETV relief claims, reflecting the fact that VGTR claims are received from a wide range of companies that are diverse in terms of their activity and size. Consequently, there are more errors and 'boundary pushing' and less record keeping. HMRC is also aware that unregulated agents might target the sector.

HMRC's compliance work where reliefs are claimed by deductions within tax returns

3.15 Within our case studies Annual Investment Allowance (AIA), and First-year allowance for plant or machinery for oil and gas trades (FYA) are examples where relief is claimed within a tax return. Business Asset Disposal Relief (BADR) is similar in that the claimant pays a lower rate of Capital Gains Tax (CGT) on the eligible gains reported in their self-assessment. Part of the challenge of undertaking compliance on claims of this kind is that the tax returns do not provide HMRC with enough data to fully risk assess capital allowances.

3.16 For the FYA, HMRC told us that all claims are assessed, including use of third-party data, and it would follow up anomalies directly with the claimant. Very occasionally a settlement cannot be reached without litigation. HMRC does not disclose a precise figure for the number of businesses that claim the relief due to the small number of claimants. HMRC cannot provide figures for compliance activity and yield generated for this allowance separately from other oil and gas allowances, as individual enquiries often encompass several allowances.[20]

3.17 For other reliefs claimed within tax returns the population of claimants can be very large, making it impossible for HMRC to enquire into all risky claims. The number of individuals claiming BADR was estimated to be 47,000 in 2020-21, and the number of entities claiming AIA was over 1 million. Therefore, for BADR and other reliefs of this type only a certain number of risked cases are referred onwards for casework. HMRC told us that selection is based on prioritising cases that it assesses as higher risk, often related to those with the highest expected compliance yield. HMRC has conducted exercises for both BADR and AIA proactively targeting claimants who are attempting to claim relief in excess of the current lifetime or annual limit. HMRC also told us that it runs regular risk profiles on corporation tax returns to identify "potential non-compliance risks".

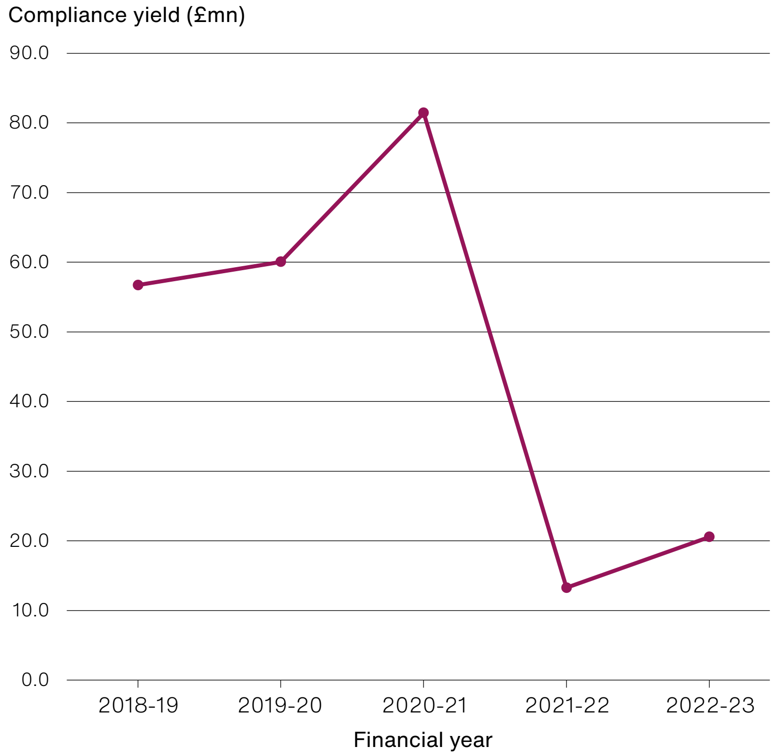
3.18 The level of compliance yield relating to capital allowance claims involving AIA carried out in recent years by HMRC is shown in **Figure 14**. For capital allowances that included an AIA claim, new compliance cases reduced significantly from 2018-19 to 2022-23, although the 2022-23 cost of the relief is expected to be 79% of the prior year level and HMRC does not consider the risk of non-compliance to be reducing. HMRC told us that this reflected the reprioritisation of compliance activities in response to the pandemic, but it is not the only reason since the number of new cases had already reduced significantly in 2019-20. HMRC has not restored activity to pre-pandemic levels but it opened open more cases in 2022-23 than in the previous two years. This data was produced at our request as HMRC does not routinely monitor compliance activity at the level of individual reliefs.

20 We note that cases under investigation across oil and gas allowances total several hundred million pounds.

Figure 14

Compliance yield for Annual Investment Allowance (AIA), 2018-19 to 2022-23

The compliance yield generated by HM Revenue & Customs (HMRC) from enquiries into AIA claims decreased by 84% in 2021-22



	2018-19	2019-20	2020-21	2021-22	2022-23
● Compliance yield	56.7	60.0	81.4	13.3	20.5

Notes

1 Compliance yield figures are in cash terms to align with HMRC's reporting of the figures.

2 This reflects compliance yield from enquiries into claims covering various capital allowances where HMRC considered AIA to be part of the enquiry. It is not possible to distinguish risks targeting the AIA specifically in the data and this therefore had to be done manually by HMRC staff for the purpose of this study. Capital allowance enquiries across HMRC's Customer Compliance Group routinely investigate claims that include more than one type of capital allowance.

3 The reduction in compliance yield partly reflects HMRC's aim to focus its resources on a smaller number of high-value risks, and move towards upstream compliance. It also reflects the overall reduction in casework that took place during the pandemic.

Source: National Audit Office analysis of HM Revenue & Customs data

Appendix One

Our evidence base

1 We reached independent conclusions on the effectiveness of HM Revenue & Customs' (HMRC's) and HM Treasury's administration and oversight of non-structural tax reliefs intended to increase UK business investment. Our conclusions are based on our analysis of evidence collected primarily between April and September 2023.

2 To identify reliefs with an investment objective we matched the published cost statistics to the published objectives by relief ID. For each relief we tagged the relief description and stated objectives for words and word-stems that could indicate an investment-related angle. We did the same to identify which reliefs were aimed at individuals and which were aimed at businesses. The list was manually checked and adjusted based on a closer reading of the description, and – where needed – desk research. When this list had been amended accordingly it was shared with HMRC and HM Treasury for comment.

Interviews and meetings

3 We conducted 39 virtual interviews and meetings between 23 January and 9 October 2023 with representatives from HMRC, HM Treasury, other government departments and wider stakeholders to inform our audit. These included:

- **Walkthroughs and teach-ins with HMRC and HM Treasury:** We attended online 'teach-ins' with officials from HMRC and HM Treasury to understand the departments' approach to: tax relief policy design, costing, forecasts, monitoring, evaluation and management of compliance risks associated with tax reliefs. We also attended online 'teach-ins' on each case study relief to inform our understanding of the reliefs and the departments' management of them.
- **Meetings with other government departments and public bodies:** We met other government departments and public bodies to understand their roles in the management of tax reliefs, their views on HMRC and HM Treasury's management of the reliefs, supporting analysis, and to further our understanding of the other support mechanisms used by the government. We spoke to representatives from:
  - Evaluation Task Force (ETF);
  - Office for National Statistics (ONS);

- Office for Budget Responsibility (OBR);
- British Film Institute (BFI);
- North Sea Transition Authority (NSTA);
- Department for Science, Innovation and Technology (DSIT);
- Department for Culture, Media & Sport (DCMS);
- British Film Commission (BFC); and
- Innovate UK, part of UK Research and Innovation (UKRI).

- **Roundtable discussions:** We held roundtable discussions with sector representatives and experts to get a more rounded view of perspectives and experiences. We spoke with representatives and members from:
  - Confederation of British Industry (CBI);
  - Chartered Institute of Taxation (CIOT); and
  - The R&D Community.
- **Semi-structured interviews with stakeholders:** We interviewed tax stakeholders and business groups to discuss their views on HMRC's management and administration of the reliefs and the impact of the reliefs on businesses. We spoke to representatives from the following organisations:
  - TaxWatch;
  - British Chamber of Commerce;
  - Institute for Government (IfG);
  - Institute of Chartered Accountants in England and Wales (ICAEW);
  - Commercial On-Demand and Broadcasting Association (COBA);
  - Deloitte;
  - PwC;
  - UK Interactive Entertainment (UKIE); and
  - Saffery.

- **Semi-structured interviews with academics and experts:** During scoping and fieldwork, we consulted academics specialising in tax to discuss their views on HMRC's management of tax reliefs to promote economic growth, and their experience with what data may be available. We spoke to representatives from:
  - University of Nottingham;
  - Institute for Fiscal Studies (IFS);
  - Oxford University Centre for Business Taxation;
  - University of Warwick; and
  - Creative industry Policy and Evidence Centre (PEC) hosted by the University of Newcastle and the Royal Society of Arts (RSA).

Document review

4 We conducted desk research of publicly available evidence. This included:

- literature review to understand academic views and analysis of tax reliefs, as well as stakeholder views and commentary on HMRC's administration of the reliefs;
- review of HMRC's published information on tax reliefs, including guidance, commentary on costs and evaluations;
- back catalogue review of previous National Audit Office (NAO) reports on tax reliefs, and enquiry work to identify previous recommendations, findings and consistent themes; and
- review of previous and ongoing work by Parliamentary committees (Committee of Public Accounts, Treasury Select Committee and the House of Lords Economic Affairs Finance Bill Sub-Committee on tax reliefs.

5 We reviewed documentation provided by HMRC and HM Treasury that is not available in the public domain. This included:

- strategic and risk documentation;
- documentation of analysis and monitoring;
- evaluation resourcing; and
- policy frameworks.

6 We also reviewed documents provided to us by our financial audit teams in relation to the audit qualification for R&D tax credit error and fraud.

Case studies

7 We conducted case studies of seven established tax reliefs to look in depth at how HMRC and HM Treasury manage reliefs throughout their lifecycle. The case study reliefs were selected purposively based on criteria including: relevance to government objectives; absolute cost; cost increase in recent years; whether action has been taken on abuse in recent years; and whether a relief has been covered by previous NAO work. We selected reliefs that utilise a mix of levers (both credits paid out and revenue foregone), and reliefs at different stages in their lifecycles to enable us to focus on different aspects of their administration. The reliefs selected on this basis are shown in **Figure 15** on pages 58 and 59.

8 For each of the case study reliefs, we assessed the effectiveness of the management of the tax relief by HMRC and HM Treasury. In particular, we considered:

- monitoring and evaluation arrangements (including the extent to which controls and monitoring have mitigated against inherent risks);
- outturn and forecast costs;
- management of compliance risks;
- consideration of the impact of the relief on businesses; and
- the speed of response and intervention.

9 We undertook these assessments utilising a range of methods including:

- **Document review.** We reviewed publicly available documents including HMRC guidance, HMRC's published costs of reliefs and commentary and evaluations. We also reviewed documentation not available in the public domain. This included: strategic and risk documentation; workforce planning documentation; and policy frameworks.
- **Interviews.** We attended online 'teach-ins' with officials from HMRC and HM Treasury on each of our case study reliefs. We also interviewed sector stakeholder and experts identified for each relief.
- **Quantitative analysis.** We reviewed public data and data provided by HMRC including, for each relief: the forecast and outturn cost; the number of claimants; distributional analysis of the uptake; compliance yield and case numbers; and data on staff usage.

Figure 15
Case study reliefs

Our case study reliefs include reliefs with a range of costs, payment mechanisms and claim processes

Relief	Objective	How relief is claimed	Rate payable or claimable	Cost (2021-22) (£mn)	Number of claims (2020-21)
Research and Development (R&D) expenditure credit (RDEC)	To support and incentivise R&D activity in the UK by companies. The relief also aims to capture wider benefits of this investment, such as improved skills	Credit payment	20% tax credit	2,815	10,450
Research and Development (R&D) tax relief for small and medium-sized enterprises (SMEs)	To support and incentivise R&D in the UK by SMEs. The relief also aims to capture wider benefits of this investment, such as improved skills	Deduction or credit payment	Up to 186% deduction	4,760 (of which 2,985 in credit payments)	75,940
Annual Investment Allowance (AIA)	To simplify the claims process by lowering the administrative burden firms face when calculating their capital allowances entitlement. Offering a 100% relief is also intended to incentivise investment by improving the cashflow for businesses investing in qualifying plant and machinery assets	Deduction	100% allowance on qualifying investment	3,800	1,260,000
First-year allowance for plant or machinery for oil and gas trades	To encourage investment to maximise the economic recovery of the UK's oil and gas resources	Deduction	100% allowance for expenditure on plant or machinery for use wholly in a ring-fence trade	1,300	<150
Business Asset Disposal Relief (BADR)	To encourage "genuine risk takers" and entrepreneurs to start up or invest in their own personal company over the long term	Deduction	10% capital gains tax rate is charged on qualifying disposals rather than the standard rate	1,200	47,000
High-end Television (HETV) Tax Relief	To encourage the production of high-end television programmes in the UK	Deduction or credit payment	Deduction of up to 80% of qualifying expenditure	829	355
Video Games Tax Relief (VGTR)	To encourage the production of video games in the UK	Deduction or credit payment	Deduction of up to 80% of qualifying expenditure	189	355

Figure 15 *continued*
Case study reliefs

Notes
1 Relief costs are on an accruals basis.
2 BADR was known as Entrepreneurs' Relief before 6 April 2020.
3 The creative sector reliefs were reformed in 2023. The HETV relief has now been grouped with Film, Animation and Children's TV reliefs in the new Audio-Visual Expenditure Credit. VGTR has been replaced by the Video Games Expenditure Credit.
4 The 20% RDEC rate is an increase from the 13% rate in place between 1 April 2020 and 31 March 2023, and lower rates in previous years.
5 R&D tax relief for SMEs allows companies to deduct an extra 86% of qualifying costs from their yearly profit in addition to a 100% deduction, which makes a total deduction of 186%. If a company makes a loss, some or all of this loss can be surrendered for a payable tax credit at a rate of 10%. However, if the company is defined as R&D intensive the credit rate is instead 14.5%.
6 HETV relief and VGTR allow companies to claim an additional deduction to reduce profits or increase a loss. If the company makes a loss, some or all of this loss can be surrendered for a payable tax credit at a rate of 25%. The additional deduction is capped at 80% of qualifying expenditure.

Source: National Audit Office analysis of HM Revenue & Customs data and guidance

Quantitative analysis

10 We reviewed public data, accounts information and management information provided by HMRC. This included:

- analysis of HMRC's published non-structural tax relief statistics to assess the cost of non-structural reliefs. This release was updated shortly before the report was due to be published, and figures were updated to align with this December 2023 release. The reference year used was therefore 2022-23;
- analysis of HMRC's supplementary statistics on R&D reliefs, creative industry reliefs and Capital Gains Tax, as well as published statistics from NSTA and BFI to triangulate and supplement data on cost and volume of claims. There is a lag between the publication of these detailed statistics and the headline cost statistics (see above). The reference year for these statistics was therefore 2021-22, reflecting the latest available data for R&D and creative reliefs at time of drafting;
- analysis on supplementary data from HMRC on forecasts and costs over time not publicly available;
- comparison of historic forecasts provided by HMRC and published by OBR with outturn cost data to understand where there has been divergence. This work is substantial since the basis for forecasts published is iterative changes, and it has been difficult to determine whether meaningful forecasts of gross costs exist and are used for internal monitoring;
- analysis of the compliance yield and compliance investigation numbers recorded against tax reliefs, non-structural reliefs and each of our case study reliefs to understand the effectiveness of HMRC's compliance work relating to non-structural reliefs; and

- analysis of financial information from HMRC on the resources associated with management of tax reliefs, as well as staffing numbers, to understand how HMRC manages its resources.

11 For the published cost statistics used to establish the total cost and number of non-structural reliefs we have used HMRC's assessment of the number of reliefs costed to date. The latest December 2023 update stated that 256 reliefs had been costed to date. The release itself included 149 single-year estimates for 150 reliefs, and 104 multi-year estimates for reliefs. This adds up to 253 cost estimates. However, HMRC told us that the actual number of cost estimates produced to date was 256 since this did not include the relief on gifts from trading stock to charity (included in the Income Tax/corporation tax charitable donations estimate). HMRC had also made a correction, after realising that two reliefs (Investors Relief and the Income Tax relief on pension schemes – member contributions) had not been counted as costed in previous publications, but their costs had been included in the estimates for Business Asset Disposal Relief and the Income Tax registered pension schemes reliefs, respectively.

12 For the purposes of this report, tax revenue figures and compliance yield estimates are presented in cash terms to align with established convention when reporting tax revenues. This has been done to be consistent with HMRC and OBR presentation of figures. To illustrate the effect of changes to the economy and tax base we have also presented relief costs as a proportion of tax revenue. We used the most up-to-date version of the GDP deflator published by HM Treasury as at December 2023 to estimate alternative growth rates. Broadly this did not generate any material difference. The notable exception is the R&D growth since 2013-14, since this covered a longer period of time. If real terms prices were used the growth rate for the SME scheme would have been 479% and the RDEC 180%.

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Design and Production by NAO Communications Team
DP Ref: 012735-001

£10.00
ISBN: 978-1-78604-530-0